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## Article

### Could the Benefits of the Public Service Loan Forgiveness Program be Retroactively Curtailed?

GREGORY CRESPI

*There is a sharp tension between the expectations that hundreds of thousands to millions of persons have or will have regarding their right to have their federal student loan debts forgiven under the Public Service Loan Forgiveness ("PSLF") program and the legitimate public concerns regarding the large costs and regressive incidence of the PSLF program's benefits. In 2017, the Trump Administration proposed abolishing the PSLF program for future federal Direct Loans, but this proposal was not adopted. A similar proposal was made in 2019 as part of the Administration's fiscal 2020 budget proposal, with little chance of adoption. But given the large costs of the program, which I estimate will eventually rise to \$12 billion per year or more as an estimated 200,000 people per year who currently have outstanding federal Direct Loans will eventually seek debt forgiveness, and given the regressively skewed incidence of its benefits in favor of relatively affluent mid-career doctors and lawyers, I think that there will be further legislative curtailment efforts made in 2020 or later by the Trump Administration or by members of Congress, this time perhaps a more aggressive proposal for retroactive elimination of the program, or at least a push for a tax law amendment to include this forgiven debt as taxable income as is now done for debts forgiven under the other federal income-based loan forgiveness plans.*

*This Article considers several contractual arguments as well as Constitutional arguments that opponents of such proposed statutes could offer. The contractual arguments against retroactive elimination of the PSLF program include arguments based on: the express loan terms; the implied contractual covenant of good faith and fair dealing; promissory estoppel; and unconscionability. Some of these arguments have considerable merit, at least for those Direct Loan borrowers who can make certain fact-specific showings. Opponents of such legislation might also be able to invoke constitutional substantive due process concerns under the authority of the 1986 Supreme Court case of *Bowen v. POSSE*. They also could offer a plausible Takings Clause argument against a tax law change if the courts*

*choose to regard the PSLF program's tax exemption for forgiven debt as a contractual commitment rather than as only a revocable privilege.*

*This Article does not take a strong normative position on these potential legal issues. It does, however, suggest a compromise that might fairly balance the interests at issue: continue the PSLF program in its current form, but repeal the tax exemption for forgiven debt so as to recapture for the Treasury in a modestly progressive manner approximately one-quarter to one-third of the benefits of the debt forgiveness. Such a compromise should probably also include a provision for spreading the payment of those taxes over at least several years after debt forgiveness to avoid unduly burdening these persons with a sudden, large tax liability that is not accompanied by the receipt of funds to pay those taxes.*

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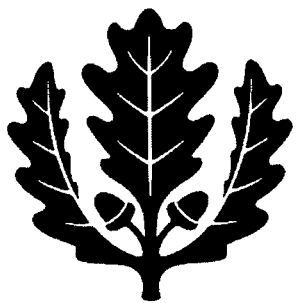
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# Could the Benefits of the Public Service Loan Forgiveness Program be Retroactively Curtailed?

GREGORY CRESPI \*

## INTRODUCTION

Starting in October of 2017, people began to qualify for tax-exempt forgiveness of their remaining federal Direct Loan student debt under the Public Service Loan Forgiveness program (“PSLF program”) after ten years of public service employment.<sup>1</sup> While very few persons have thus far had their debts forgiven under the program, I estimate in Part III of this Article that eventually 200,000 or more Direct Loan borrowers will qualify for, and seek, debt forgiveness each year.

But this anticipated large-scale debt forgiveness may not actually take place. As I also estimate in Part III, the program’s annual cost to taxpayers could eventually grow to as large as \$12 billion to \$18 billion per year, and its benefits would be regressively skewed in favor of relatively affluent mid-career doctors and lawyers with large loan debts. Recognizing these significant cost and distributional concerns, the Obama Administration in 2014 proposed to sharply limit the amount of debt that could be forgiven under the program, but this proposal was not enacted into law.<sup>2</sup> The Trump Administration then, in its first proposed budget in May of 2017, went even further and called for prospective elimination of the PSLF program for future Direct Loans, but this proposal also failed to obtain Congressional approval.<sup>3</sup>

Given the PSLF program’s large projected costs and regressive distribution of benefits—features which will become much more visible once substantial debts start being forgiven on a large scale—there will likely be efforts made by the Trump Administration (or a later administration) or

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<sup>1</sup> Preston Cooper, *Everyone Calm Down About Rejected Student Loan Forgiveness Applications*, FORBES (Sep. 25, 2018, 3:00 AM), <https://www.forbes.com/sites/prestoncooper2/2018/09/25/everyone-calm-down-about-rejected-student-loan-forgiveness-applications>.

<sup>2</sup> U.S. DEP’T OF EDUC., FY 2015 EDUCATION BUDGET SUMMARY AND BACKGROUND INFORMATION 54 (2014), <https://www2.ed.gov/about/overview/budget/budget15/index.html> [<https://perma.cc/5FBR-G4L9>].

<sup>3</sup> OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, BUDGET OF THE U.S. GOVERNMENT: A NEW FOUNDATION FOR AMERICAN GREATNESS, FISCAL YEAR 2018 20 (2017) [hereinafter TRUMP PROPOSED BUDGET 2017], <https://www.govinfo.gov/content/pkg/BUDGET-2018-BUD/pdf/BUDGET-2018-BUD.pdf>.

by members of Congress to take even more aggressive action and *retroactively* repeal the PSLF program with regard to persons who have taken out Direct Loans but have not yet been granted debt forgiveness.<sup>4</sup> If this occurs, it will be very disappointing, and in some instances, financially devastating to the hundreds of thousands—even perhaps millions—of persons who will not yet have qualified for debt forgiveness by completing ten years of qualifying public service but who have relied on the availability of eventual debt forgiveness in making their borrowing and subsequent employment decisions.

But these people may have some legal recourse against the implementation of such retroactive legislation if it is signed into law. There are a number of contractual and constitutional arguments that can be made against retroactive repeal of the PSLF program, or against elimination of the current tax exemption for debt forgiven under that program. This Article will consider those arguments in some detail.

My overall conclusion is that it is unclear whether any of those arguments against such retroactive legislation would be successful. I believe that several of those legal arguments do have considerable merit, and one or more of them may be accepted by the courts at least for a subset of Direct Loan borrowers. In contrast, while several somewhat plausible legal arguments against repeal of the tax exemption for debt forgiven under that program can also be made, they are much less convincing and are unlikely to prevail.

As a matter of social policy, I think that it is a close and difficult question as to whether a retroactive repeal of the PSLF program, or a removal of the tax exemption for debt forgiven under that program, is justified. On the one hand, hundreds of thousands of indebted graduates over the past decade have relied, at least in part, on the prospects of debt forgiveness after ten years in initially deciding to take on these loans, and in then deciding to accept public service positions that often pay relatively modest compensation.<sup>5</sup> The PSLF program has clearly been successful in encouraging people to choose public service careers—one of its primary objectives.<sup>6</sup> On the other hand, as I will later demonstrate, the program will soon become very expensive. The annual costs of this program may eventually reach \$12 billion to \$18 billion per year, a substantial sum. In addition, the benefits of that program will be

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<sup>4</sup> See JASON DELISLE, BROOKINGS INST., THE COMING PUBLIC SERVICE LOAN FORGIVENESS BONANZA 3, 5–7 (2016) [https://www.brookings.edu/wp-content/uploads/2016/09/es\\_20160922\\_delisle\\_evidence\\_speaks.pdf](https://www.brookings.edu/wp-content/uploads/2016/09/es_20160922_delisle_evidence_speaks.pdf) (discussing that new data indicates that PSLF is growing rapidly and arguing that policymakers should curtail or even eliminate PSLF).

<sup>5</sup> See AM. BAR ASS'N, ISSUE RESOURCES: PUBLIC SERVICE LOAN FORGIVENESS (Jan. 28, 2019), [https://www.americanbar.org/advocacy/governmental\\_legislative\\_work/aba-day/resources/pslf.html](https://www.americanbar.org/advocacy/governmental_legislative_work/aba-day/resources/pslf.html) (describing the PSLF program's effect in making it more feasible for young lawyers with a great deal of debt to choose careers in public service, which generally pay less than other legal jobs).

<sup>6</sup> *Id.*

decidedly regressive in their incidence, heavily skewed towards mid-career doctors and lawyers.<sup>7</sup>

I do not have strong views or any special insights as to how this tension should be resolved. I later will suggest for discussion one possible compromise resolution: continuing the current PSLF program but repealing the tax exemption for forgiven debt so that approximately one-quarter to one-third, or more, of the benefits of forgiveness of existing loans will be recaptured immediately in federal or state income tax revenues. These new taxes would automatically be imposed in a somewhat progressive manner given the application of progressive marginal tax rates to higher-debt borrowers with generally higher incomes in the year of forgiveness. This is the approach taken under all of the other federal income-based loan repayment programs, with the taxation of forgiven debt recognized in the year of forgiveness, and this approach may make sense for the PSLF program as well.<sup>8</sup> If this approach is followed, however, some provision should be made to allow persons to pay these taxes over at least several years so as to avoid unduly burdening these persons having debts forgiven with the imposition of a potentially large tax obligation without funds to pay those taxes.

The PLSF program<sup>9</sup> was enacted in 2007 and went into effect on October 1 of that year.<sup>10</sup> Under this program, a person who meets the following criteria will be entitled to forgiveness of any principal and interest balance outstanding<sup>11</sup>—the person must have borrowed money for education through a federal Direct Loan;<sup>12</sup> worked for a total of 120 months (which

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<sup>7</sup> DELISLE, *supra* note 4, at 2 (“Recent figures on budget costs, enrollment, and projected loan forgiveness all point to a public service loan forgiveness bonanza on the horizon—one that will significantly distort incentives and pricing in higher education and disproportionately benefit borrowers with graduate and professional degrees.”).

<sup>8</sup> Letter from Eric Solomon, Assistant Sec’y for Tax Policy, U.S. Dep’t of the Treasury, to Rep. Sander Levin, U.S. House of Representatives 2–4 (Sept. 19, 2008), [http://www.ibrinfo.org/files/Treasury\\_response\\_levin.pdf](http://www.ibrinfo.org/files/Treasury_response_levin.pdf) [<https://perma.cc/UA4B-TFWD>] (explaining that loans forgiven under certain federal income-based repayment plans would be considered taxable income, but loans forgiven under the PSLF program would *not* be considered taxable income).

<sup>9</sup> Throughout this Article, I will refer to the statutory Public Service Loan Forgiveness provisions as a “program” in accordance with commonly accepted parlance. In actuality, however, those provisions do not really establish a separate loan repayment “program,” but only create a special accelerated debt forgiveness mechanism that complements the various federal student loan repayment plans.

<sup>10</sup> College Cost Reduction and Access Act, Pub. L. No. 110-84, § 401, 121 Stat. 784, 800 (2007) (codified as amended at 20 U.S.C. § 1087e(m) (2012)).

<sup>11</sup> 20 U.S.C. § 1087e(m)(2).

<sup>12</sup> *Id.* § 1087e(m)(1). Federal Direct Loans have been made since 1994 under the Student Loan Reform Act of 1993, which was included in the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, tit. IV, § 4021, 107 Stat. 312, 341 (1993) (codified as amended at 20 U.S.C. § 1087e(d)). There are many other student loan programs, including the Federal Family Education Loan Program (FFELP), which was widely used prior to being discontinued in 2010. Under FFELP, the federal government guaranteed student loans made by private lenders; the Perkins federal loan program; and various other private, state, and institutional loan programs. See *Federal Family Education Loan (FFEL)*

need not be consecutive)<sup>13</sup> in a qualified public service job;<sup>14</sup> and made regular monthly loan repayments under a qualifying loan repayment plan after October 1, 2007.<sup>15</sup> Moreover, that forgiven debt will *not* be regarded as taxable cancellation of indebtedness income, unlike the manner in which forgiven debt is treated under the several other federal income-based student loan repayment programs that provide for debt forgiveness.<sup>16</sup> The Department of Education (“DOE”) has subsequently adopted regulations implementing the PSLF program.<sup>17</sup>

Only a few people have met the ten-year employment requirement and have qualified for debt forgiveness over the last few months of 2017 and through 2018.<sup>18</sup> In 2019 and thereafter, the number of people qualifying for and obtaining debt forgiveness will surely grow rapidly and very substantially.<sup>19</sup> That is, unless the Trump Administration (or a later

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*Program*, FED. STUDENT AID, U.S. DEP’T OF EDUC., [https://studentaid.ed.gov/sa/glossary#letter\\_f](https://studentaid.ed.gov/sa/glossary#letter_f) (last visited Feb. 6, 2019) (defining the FFEL program); *Perkins Loans*, FED. STUDENT AID, U.S. DEP’T OF EDUC., <https://studentaid.ed.gov/sa/types/loans/perkins> (last visited Oct. 6, 2018) (explaining the Federal Perkins Loan Program). As of 2011, there were over \$489 billion of outstanding FFELP loans taken out by 23.8 million borrowers, much more than the \$350 billion in Direct Loans that were outstanding at that time (which grew to \$963 billion by 2017), and \$8.3 billion in outstanding Perkins loans made to 2.9 million borrowers. *Federal Student Aid Portfolio Summary*, FED. STUDENT AID, U.S. DEP’T OF EDUC., <http://studentaid.ed.gov/sa/about/data-center/student/portfolio> (last visited Feb. 6, 2019). Loans made under any of these other programs are not eligible for debt forgiveness under PSLF. *Which Types of Federal Student Loans Qualify for PSLF?*, FED. STUDENT AID, U.S. DEP’T OF EDUC., <https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/public-service#eligible-loans> (last visited Feb. 6, 2019). However, FFELP and Perkins loans can later be consolidated into Direct Loans, which are eligible for PSLF forgiveness, although any loan repayments made under those programs before consolidation will not count towards the ten-year repayment period required for eventual debt forgiveness. *Id.* A substantial number of borrowers who would otherwise be eligible for PSLF forgiveness in 2017 (or the following few years) will likely be precluded from eligibility because they will have incurred their debt under the FFELP or Perkins programs and not timely consolidated it into Direct Loans upon graduation.

<sup>13</sup> 20 U.S.C. § 1087e(m)(1)(A).

<sup>14</sup> *Id.* § 1087e(m)(1)(B).

<sup>15</sup> *Id.* § 1087e(m)(1)(A)(i–iv).

<sup>16</sup> I.R.C. § 108(f)(1) (2012) (excluding from the definition of gross income student loans discharged by reason of the student working for a certain period of time in public service professions).

<sup>17</sup> 34 C.F.R. § 685.219 (2018).

<sup>18</sup> As of December 31, 2018, 58,293 PSLF program debt forgiveness applications had been filed and had their processing completed, but of those applications only 610 applications—only approximately 1% of those filed, a strikingly low figure—had been approved by the loan servicer, and only 338 borrowers had had their debt discharges processed. See *Public Service Loan Forgiveness (PSLF) Program Data*, FED. STUDENT AID, U.S. DEP’T OF EDUC., <https://studentaid.ed.gov/sa/sites/default/files/fsawg/datacenter/library/pslf-report.xls> (last visited May 22, 2019). See also Annie Nova, *Public Service Loan Forgiveness is Going Wrong for Most People – Meet Some of Them*, CNBC (Oct. 10, 2018), <https://www.cnbc.com/2018/09/21/the-education-department-data-shows-how-rare-loan-forgiveness-is.html> (describing how only ninety-six out of 30,000 applicants qualified for debt forgiveness as of June 30, 2018).

<sup>19</sup> When the PSLF program was enacted into law in 2007, the Congressional Budget Office estimated that “approximately 50,000 new borrowers each year would eventually be eligible for, and participate in, income-contingent loan forgiveness each year.” H.R. REP. NO. 110-210, at 72 (2007). It is



administration) and Congress go beyond the Administration's current proposal to prospectively abolish the PSLF program. For instance, they could instead enact a statute which will deny loan forgiveness not only to future borrowers, but also to those persons who have previously taken out Direct Loans and accepted public service employment in reliance on being able to later utilize the PSLF program, but who have not yet qualified for debt forgiveness at the time of enactment of such a restrictive statute.<sup>20</sup>

The Trump Administration's May 22, 2017 budget proposal tersely stated that "the Budget eliminates the Public Service Loan Forgiveness program,"<sup>21</sup> but then later stated that "[a]ll student loan proposals apply to loans originated on or after July 1, 2018, except those provided to borrowers to finish their current course of study."<sup>22</sup> This proposal therefore would have applied only prospectively to future Direct Loans taken out after that date and would even have retained PSLF program debt forgiveness eligibility for those post-July 1, 2018 Direct Loans that were taken out by persons completing a course of study that was commenced before that date.<sup>23</sup> Direct

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not entirely clear from this statement whether the CBO estimate was for the PSLF program alone or for all borrowers participating in any of the income-contingent repayment plans. *Id.* It appears likely that only estimated eventual PSLF forgiveness was included in this estimate. As I will later discuss herein, this number is likely a substantial underestimate of eventual steady-state borrower participation.

<sup>20</sup> The Trump Administration's first proposed DOE budget called for ending the PSLF program as part of an overall attempt to reduce the DOE's budget by \$9.2 billion, or 13.5% of the current approved level of spending. TRUMP PROPOSED BUDGET 2017, *supra* note 3, at 20; see also Emma Brown et al., *Trump's First Full Education Budget: Deep Cuts to Public School Programs in Pursuit of School Choice*, WASH. POST (May 17, 2017), [https://www.washingtonpost.com/local/education/trumps-first-full-education-budget-deep-cuts-to-public-school-programs-in-pursuit-of-school-choice/2017/05/17/2a25a2cc-3a41-11e7-8854-21f359183e8c\\_story.html](https://www.washingtonpost.com/local/education/trumps-first-full-education-budget-deep-cuts-to-public-school-programs-in-pursuit-of-school-choice/2017/05/17/2a25a2cc-3a41-11e7-8854-21f359183e8c_story.html) (describing the Administration's attempt to reduce the DOE's budget by \$9.2 billion and the implications that budget reforms have for college students seeking federal loans).

<sup>21</sup> TRUMP PROPOSED BUDGET 2017, *supra* note 3, at 20.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* The Trump Administration proposal left unclear whether this "current course of study" exception would apply to Direct Loans taken out to finance subsequent graduate school education by persons who were still completing their undergraduate programs as of July 1, 2018. Would a graduate degree that builds directly upon the knowledge obtained in an undergraduate program be regarded as part of the same "course of study" as the undergraduate program? As examples of this question: How about a student who obtains a Ph.D. in the same field as his or her undergraduate study? A law degree obtained following graduation from a pre-law undergraduate program? A medical school degree based upon the necessary predicate of a pre-med undergraduate curriculum? The proposal was also unclear as to whether it would apply to pre-July 1, 2018 FFELP or Perkins loans that were consolidated into Direct Loans after that date. See 20 U.S.C. § 1087e(m)(1) (2012) (outlining the repayment plan for public service employees).

This 2017 budget proposal for prospectively eliminating the PSLF program was not adopted by Congress. In March 2019, the Trump Administration released its proposed fiscal 2020 budget which again called for prospective elimination of the PSLF program on very similar terms to those proposed earlier, this time rendering ineligible for the program borrowers who take out a new Direct Loan after July 1, 2020, except for those borrowers who do so to finish a current course of study. WHITE HOUSE, A BUDGET OF THE U.S. GOVERNMENT: A BUDGET FOR A BETTER AMERICA, FISCAL YEAR 2020 32 (2019)

Loan borrowers would therefore have continued to be eligible for PSLF program debt-forgiveness for any pre-July 1, 2018 loans (and for some program-completing, post-July 1, 2018 loans) once they met the ten-year public service employment requirement. Under this proposal, the number of persons obtaining PSLF program debt forgiveness annually—which will rise rapidly starting in 2018—would begin to decline very rapidly after 2028 eventually dwindling to close to zero by a few years after that date. However, this 2017 budget proposal regarding the PSLF program was not adopted by Congress.

As I will later demonstrate in Part III of this Article, however, the cost to taxpayers of continuing to provide debt forgiveness to existing Direct Loan borrowers under the current PSLF debt-forgiveness terms, and with the current favorable tax treatment of that forgiven debt, may eventually rise to as much \$12 billion to \$18 billion per year. This is a much larger sum than most policymakers have so far expected or that media commentators have discussed.<sup>24</sup> The Trump Administration (or a later Administration) and Congress will surely be tempted to have any statutory curtailment of the PSLF program apply retroactively to existing Direct Loan debts not yet forgiven to avoid a decade of drain on the Treasury, probably totaling well over \$100 billion between 2019 and 2028.<sup>25</sup>

There will surely be strong political resistance to adopting such a harsh retroactive measure that would take away PSLF program privileges from existing borrowers who now expect to eventually qualify for debt forgiveness. If that resistance proves insurmountable, those persons who favor such action may decide to instead propose a statutory change to the

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[hereinafter TRUMP PROPOSED BUDGET 2019], <https://www.whitehouse.gov/wp-content/uploads/2019/03/budget-fy2020.pdf>.

<sup>24</sup> See, e.g., DELISLE, *supra* note 4, at 7 (“Policymakers appear to know little about the Income-Based Repayment program and the Public Service Loan Forgiveness benefit for federal student loans. That lack of awareness is troubling, as these programs are a major force in how students are financing their educations.”).

<sup>25</sup> Calculating the net savings to the Treasury by retroactive termination of the PSLF program is a complicated undertaking for several reasons. First of all, most people who would utilize the program’s debt forgiveness provisions are now enrolled in one or another federal income-based repayment plan and will, if the PSLF program is terminated, still be able to eventually obtain debt forgiveness, but not until after twenty or twenty-five years. Gregory Crespi, *The Obama Administration’s New “REPAYE” Plan for Student Loan Borrowers: Not Much Help for Law Graduates*, 35 QUINNIPIAC L. REV. 323, 332–33 (2017) [hereinafter Crespi (2017)]. So, the amount of debt that each of those people will have left to forgive after the longer repayment period would have to be estimated, requiring long-term projections of average salaries. Then, the present value of those forgiven debts would have to be offset from the 2017–2018 savings. In addition, debts forgiven after twenty or twenty-five years would be regarded as taxable income under current law. Gregory Crespi, *Should We Defuse the ‘Tax Bomb’ Facing Lawyers Who are Enrolled in Income-Based Student Loan Repayment Plans?*, 68 S.C. L. REV. 117, 131 (2016) [hereinafter Crespi (2016)]. This will significantly reduce the net offset of the savings from retroactive PSLF program termination. The net impact of these alternative debt forgiveness options would be to significantly reduce the taxpayer savings from PSLF termination, but it would be difficult to estimate by exactly how much.

Internal Revenue Code that would also have retroactive impacts so that debt forgiven under the PSLF program would be treated as taxable cancellation of indebtedness income in the year the debt is forgiven. This possible change to the Internal Revenue Code would treat debts forgiven under the PSLF program in the same manner as debts forgiven under each of the several other federal income-based student loan programs, thus recapturing approximately one-quarter to one-third of this forgiven debt in federal or state income tax payments.<sup>26</sup>

But would a statute that goes beyond the prior Trump Administration proposals and retroactively curtails or eliminates PSLF privileges for existing Direct Loan borrowers, or which changes the tax treatment of debts forgiven under this program for existing Direct Loan borrowers, be given legal effect by the courts? Or would those debt forgiveness and tax treatment privileges be regarded by the courts as contractual obligations of the federal government, and moreover as contractual obligations that cannot be legally abrogated by statute given constitutional limitations? These are the questions that I will consider in this Article.

There is no provision under the PSLF program for persons to formally enroll in the program prior to filing their application seeking debt forgiveness.<sup>27</sup> This application cannot be filed until they can document that they have met the required ten-year period of qualifying public service employment.<sup>28</sup> The DOE in 2012 implemented a voluntary certification procedure through which prospective applicants may have annual periods of employment certified as qualifying public service employment before filing an application for debt forgiveness once they have met the ten-year employment requirement.<sup>29</sup> A million borrowers have already availed

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<sup>26</sup> That forgiven debt would be taxed as income at the debtor's marginal personal tax rate, which would generally range from approximately 25% to a maximum of 37%. *Id.* at 131. In addition, many states would also impose state income taxes on this forgiven debt once it is recognized as income for federal tax purposes. *Id.* I have elsewhere estimated the overall average tax rate that will be imposed on forgiven debt under the federal income-based loan repayment programs at approximately 33.3%. *Id.* at 159–60; Gregory Crespi, *Will the Income-Based Repayment Program Enable Law Schools to Continue to Provide "Harvard-Style" Legal Education?*, 67 SMU L. REV. 51, 90 (2014) [hereinafter Crespi (2014)]. See also Crespi (2017), *supra* note 25, at 346–47 n.81 (noting that many graduates would have a larger amount of debt forgiven and therefore would owe more in both state and federal income taxes).

<sup>27</sup> See DELISLE, *supra* note 4, at 3 (“[G]auging enrollment in PSLF is tricky because borrowers can retroactively claim benefits for work and payments as far back as 2007. . . . [T]he Department developed an optional certification process in 2012 so that borrowers and the government have more clarity and certainty about who qualifies and is enrolling in PSLF. Borrowers may . . . submit a form to the Department documenting their qualifying loan payments, and the Department will determine whether they qualify for PSLF.”).

<sup>28</sup> *Id.*

<sup>29</sup> See U.S. DEP'T OF EDUC., OMB NO. 1845-0110, PUBLIC SERVICE LOAN FORGIVENESS (PSLF): EMPLOYMENT CERTIFICATION FORM, <http://studentaid.ed.gov/sa/sites/default/files/public-service-employment-certification-form.pdf> (last visited Oct. 3, 2018) (describing the application process, eligibility standards and other important information about the PSLF program). See also U.S. DEP'T OF

themselves of this certification procedure even though there is no requirement that persons do so in advance of their application for debt forgiveness.<sup>30</sup> The number of new borrowers obtaining such certifications each year has been growing rapidly in recent years, with 218,223 persons first receiving an employment certification in 2016,<sup>31</sup> a sharp 52.3% increase over the 143,276 people who first did so in 2015,<sup>32</sup> and with another 249,109 persons then first receiving an employment certification in 2017, and with another 197,496 persons then first receiving an employment certification during just the first nine months of 2018.<sup>33</sup>

The fact that people are not required to give the DOE prior notice of their intent to utilize the PSLF program before they seek to obtain debt forgiveness means that any advance estimates of how many people will actually seek debt forgiveness, and how large the amounts of debt forgiven will be—both individually and in the aggregate—are highly speculative; few people have yet qualified for forgiveness.<sup>34</sup> As previously noted, a substantial and rapidly growing number of borrowers have indicated their interest in the program by obtaining one or more of the voluntary annual employment certifications,<sup>35</sup> but this number bears no necessary relationship to the number of people who will eventually qualify and apply for debt forgiveness.

The initial number of persons obtaining debt forgiveness after meeting the ten-year employment requirement after October 1, 2017 has been small.<sup>36</sup> Only those very few Direct Loan borrowers who have held

EDUC., PUBLIC SERVICE LOAN FORGIVENESS EMPLOYMENT CERTIFICATION FORMS REPORT (Dec. 31, 2016), [hereinafter ECF REPORT (2018)], <https://studentaid.ed.gov/sa/sites/default/files/fsawg/datacenter/library/ECFReport.xls> (detailing the number of borrowers who submitted an employment certification form (ECF) between 2012 and 2016).

<sup>30</sup> As of the third quarter of 2018, a total of 999,536 borrowers have had at least one employment certification application approved. ECF REPORT (2018), *supra* note 29.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> See Mark Krantowitz, *Very Few Borrowers Qualify for Public Service Loan Forgiveness*, FORBES (Sept. 20, 2018, 2:05 PM), <https://www.forbes.com/sites/markkrantowitz/2018/09/20/very-few-borrowers-qualify-for-public-service-loan-forgiveness/#286124782a6f> (noting that only one percent of applications for loan forgiveness have been approved as of June 30, 2018). This very low 1% approval rate has continued through December 31, 2018. See *Public Service Loan Forgiveness (PSLF) Program Data*, *supra* note 18.

<sup>35</sup> See *supra* text accompanying notes 29–33.

<sup>36</sup> As of December 31, 2018, 53,749 borrowers had submitted loan forgiveness applications under the PSLF program, and only 620 applications for loan forgiveness had been granted by that date, approximately a 99% denial rate. See *Public Service Loan Forgiveness (PSLF) Program Data*, *supra* note 18. See also U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-18-547, PUBLIC SERVICE LOAN FORGIVENESS: EDUCATION NEEDS TO PROVIDE BETTER INFORMATION FOR THE LOAN SERVICER AND BORROWERS 11 (2018). The most common reasons for the many denials were: (1) the borrower's employment or loans did not qualify; (2) the applicant had not made enough monthly payments; and (3) the applications were incomplete. *Id.* These strikingly high denial rates were attributed largely to

qualifying public service employment every year since late-2007 when the PSLF program was first adopted—and who also have met the other program requirements—were qualified at the time. But it is certain that the number of people applying for debt forgiveness will grow rapidly as increasing numbers of borrowers become more aware of the program's generous debt forgiveness provisions. Awareness will surely spread once it becomes widely publicized that many people are taking advantage of those provisions, and also as they begin to meet the ten-year public service employment period requirement. It has been estimated that roughly one-quarter of all jobs qualify as public service jobs under the PSLF program's broad definition,<sup>37</sup> which is a strikingly high proportion. By the time the

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borrower confusion regarding the program requirements. *Id.* at 11–12. It was estimated that the number of loan forgiveness grants would rise to approximately 700 by September 30, 2018. *Id.* at 11. A subsequent release by the Department of Education stated that as of December 31, 2018, 53,749 borrowers had submitted 65,500 applications for loan forgiveness under the PSLF program. Of the 58,293 applications that were processed, only 610 had been approved, and only 338 borrowers had had their loans discharged, totaling \$21.13 million in discharged debt. See *Public Service Loan Forgiveness (PSLF) Program Data*, *supra* note 18.

In a recently approved \$1.3 trillion spending bill, Congress authorized \$350 million to expand the PSLF program for people who met employment and loan requirements but failed to qualify for debt forgiveness because they had chosen an ineligible loan repayment plan. Moriah Balingit & Danielle Douglas-Gabriel, *Congress Rejects Much of Betsy DeVos's Agenda in Spending Bill*, WASH. POST (Mar. 24, 2018), [https://www.washingtonpost.com/news/education/wp/2018/03/21/congress-rejects-much-of-betsy-devos-agenda-in-spending-bill/?utm\\_term=.94023c7aac21](https://www.washingtonpost.com/news/education/wp/2018/03/21/congress-rejects-much-of-betsy-devos-agenda-in-spending-bill/?utm_term=.94023c7aac21). In its fiscal year 2019 appropriations, Congress added an additional \$350 million to this program expansion, for a total of \$700 million. Letter from Senator Elizabeth Warren et al., to the Honorable Roy Blunt & Patty Murray (April 15, 2019), *available*

*at* <https://www.warren.senate.gov/imo/media/doc/FY20%20TEPSLF%20Request%20Letter.pdf>. The precise criteria for qualifying for debt discharge under this new program are not yet clear. See Ron Lieber, *A Student Loan Fix, with Catches*, N.Y. TIMES, Mar. 31, 2018, at B1 (“We’re still months away from knowing the details of how the \$350 million fund will work. And if you think you’re repaying your debt correctly under the many terms of the program, there’s a decent chance you’re not.”). In addition, that \$350 million sum is actually quite modest in this context; it would suffice to discharge only 7,000 debts averaging \$50,000 apiece, probably far from sufficient to provide relief for all those who inadvertently chose (or were directed by their loan services to choose) an ineligible repayment plan. *Id.*

<sup>37</sup> Delisle, *supra* note 4, at 3. See also U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-15-663, FEDERAL STUDENT LOANS: EDUCATION COULD DO MORE TO HELP ENSURE BORROWERS ARE AWARE OF REPAYMENT AND FORGIVENESS OPTIONS 27 (Aug. 2015) [hereinafter GAO-15-663], <https://www.gao.gov/assets/680/672136.pdf> (noting that an estimated 24.7% of U.S. workers (32.5 million out of 131.7 million workers nationwide) were in PSLF-qualifying public service jobs based on 2012 employment data from the Bureau of Labor Statistics). The Government Accountability Office has also estimated that as of June 2016, approximately 24% of all Direct Loan borrowers were enrolled in an income-based loan repayment plan, and approximately 40% of all Direct Loan debts were being repaid through such plans. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-17-22, FEDERAL STUDENT LOANS: EDUCATION NEEDS TO IMPROVE ITS INCOME-DRIVEN REPAYMENT PLAN BUDGET ESTIMATES 8–9 (Nov. 2016), <https://www.gao.gov/assets/690/681064.pdf> [hereinafter GAO-17-22].

The statutory definition of “public service job” for the PSLF program is very broad. It includes all full-time employment by any level of government, by a qualifying 501(c)(3) or 501(a) organization, or by any of a number of public service activities done on a full-time basis for any employer, even if public service is not the primary purpose of the employer:

program roughly reaches a “steady state” in terms of the number of people who seek debt forgiveness each year, this number could become quite large—perhaps in the neighborhood of 200,000 people each year or more.<sup>38</sup>

(B) Public service job

The term “public service job” means—

(i) a full-time job in emergency management, government (excluding time served as a member of Congress), military service, public safety, law enforcement, public health (including nurses, nurse practitioners, nurses in a clinical setting, and full-time professionals engaged in health care practitioner occupations and health care support occupations, as such terms are defined by the Bureau of Labor Statistics), public education, social work in a public child or family service agency, public interest law services (including prosecution or public defense or legal advocacy on behalf of low-income communities at a non-profit organization), early childhood education (including licensed or regulated childcare, Head Start, and State funded prekindergarten), public service for individuals with disabilities, public service for the elderly, public library sciences, school-based library sciences and other school-based services, or at an organization that is described in section 501(c)(3) of title 26 and exempt from taxation under section 501(a) of such title; or

(ii) teaching as a full-time faculty member at a Tribal College or University as defined in section 1059c(b) of this title and other faculty teaching in high-needs subject areas or areas of shortage (including nurse faculty, foreign language faculty, and part-time faculty at community colleges), as determined by the Secretary.

20 U.S.C. § 1087e(m)(3)(B) (2018).

By regulation, the DOE has attempted to narrow PSLF program eligibility, but in a manner that is arguably inconsistent with the statute and subject to challenge. See Gregory Crespi, *The Public Service Loan Forgiveness Program: The Need for Better Eligibility Regulations*, 66 BUFF. L. REV. 819, 833–43 (2018) (noting concerns that the regulations issued in 2008 by the DOE are “incomplete and in some important ways inconsistent with the governing statute”).

<sup>38</sup> There were approximately 31.9 million Direct Loan borrowers as of the first quarter of 2017. *Federal Student Aid Portfolio Summary*, *supra* note 12. 7.66 million of them are enrolled in income-based loan repayment plans. See GAO-17-22 *supra* note 37, at 8–9 (stating that 24% of Direct Loan borrowers are enrolled in income-based loan repayment plans). Assuming, based on GAO statistics, that 24.7% of those 7.66 million borrowers work in qualifying public service positions, then 1.89 million public service employees will likely have significant outstanding debt after ten years of employment and will therefore seek PSLF forgiveness once eligible. See GAO-15-663 *supra* note 37, at 27 (explaining that 24.7% of U.S. workers were employed in PSLF-qualifying public service jobs).

For the long-term steady-state, approximately 10% of those 1.89 million people will meet the ten-year employment requirement each year. These 189,000 people will be replaced in the PSLF program “pipeline” by an approximately equal-size cohort of new employees also enrolled in income-based loan repayment plans. But it seems likely that given the relatively modest salaries paid by most public service positions, a significantly more than 24% of those Direct Loan borrowers who work in public service positions will have enrolled in an income-based loan repayment plan, exceeding the overall average rate of enrollment for Direct Loan borrowers. In addition, the proportion of Direct Loan borrowers enrolling in income-based repayment plans has doubled in the past three years. See GAO-17-22 *supra* note 37, at 8–9 (“The percent of borrowers participating in [income-driven repayment] plans more than doubled over the same time period to 24[%].”). This will likely continue to increase given rising student loan debt and continuing relatively poor employment prospects. Therefore, it is very possible that the eventual number of people seeking PSLF forgiveness each year might substantially exceed 200,000.

Based on the discussion above, approximately 76%—or 5.99 million—of Direct Loan borrowers who work in public service have not enrolled in an income-based loan repayment plan. These people are

Given that many of these people will have substantial amounts of debt forgiven,<sup>39</sup> in particular many law school graduates<sup>40</sup> and medical school graduates,<sup>41</sup> the annual cost to the Treasury for this program could easily grow to a multi-billion dollar sum,<sup>42</sup> as I will demonstrate in Part III of this Article.

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likely to have, on average, smaller initial loan debts than those who have enrolled in an income-based loan repayment plan since persons with smaller debts obtain less of an advantage from such income-based repayment plans, sometimes much less, and are therefore less likely to enroll in such plans than are high-debt persons, such as law school graduates, who often have six-figure debt loads and who will benefit handsomely. The large majority of those who have not enrolled in an income-based plan repayment plan will fully or almost fully repay their debts after ten years of public service employment since ordinary repayment plans will require relatively large monthly payments that will be sufficient to fully or almost fully amortize typical undergraduate loan debts, particularly given the somewhat lower interest rates that apply to undergraduate loans as compared to graduate student loans. Therefore, it is likely that they will either not seek PSLF forgiveness at all or will have only minimal debt remaining to be forgiven.

<sup>39</sup> Jason Delisle estimates that the median debt load of those who have obtained one or more PSLF employment certification(s) is over \$60,000, and that nearly thirty percent of have a debt load of over \$100,000. DELISLE, *supra* note 4, at 4. He also finds that eighty percent of borrowers who have obtained one or more PSLF employment certifications have borrowed more than \$30,000 and concludes that “PSLF is really a *de facto* loan forgiveness program for graduate students . . . . [T]he program is dominated by students who attended graduate and professional school.” *Id.* See also Barbara Hoblitzell et al., Fed. Student Aid, U.S. Dep’t of Educ., Public Service Loan Forgiveness, Presentation at the 2015 FSA Training Conference for Financial Aid Professionals (Dec. 2015), <https://fsaconferences.ed.gov/conferences/library/2015/2015FSAConfSession5.ppt> (providing a step-by-step explanation of PSLF).

<sup>40</sup> Many law students will graduate with well over \$150,000 of combined law school and undergraduate student loan debt. See Crespi (2016), *supra* note 25, at 154–55 n.110 (calculating the average combined undergraduate and law school debt for a student who attended law school between 2011 and 2014 at approximately \$160,000). For an extended discussion of the magnitude of law school graduate debt loads, see generally Crespi (2017), *supra* note 25; Crespi (2016), *supra* note 25.

<sup>41</sup> One might think that most doctors would earn substantial enough incomes during their first ten years of medical practice that even payments of only ten percent of their discretionary income, as required under the PAYE or IBR plans, would fully repay substantial medical school debts before qualifying for debt forgiveness under the PSLF program. However, many doctors will spend four years in residency—at a relatively low salary—at a hospital that qualifies as a public service employer, and then will serve up to another three years in a similarly low-paying qualifying internship. See Farran Powell, *Think About Paying Your Loans During Medical Residency*, U.S. NEWS & WORLD REP. (Feb. 8, 2018, 8:00 AM), <https://www.usnews.com/education/best-graduate-schools/paying/articles/2018-02-08/think-about-paying-student-loans-during-medical-residency> (“While the earning potential is high among physicians, the years spent in residency are oftentimes marked by low pay. . . . [A] medical resident is paid around \$51,000 a year on average.”). Even after several later years of making more substantial loan repayments out of a larger income, doctors would often still have substantial amounts of debt remaining to be forgiven under the program.

<sup>42</sup> The Congressional Budget Office has estimated that by capping the amount of debt that could be forgiven under the PSLF program at \$57,500 and eliminating the cap on required monthly repayments to the amount owing under standard ten-year loan repayment terms—both recommended in 2014 by the Obama Administration—the government would save \$12.1 billion over the ten-year-period from 2015 to 2024. DELISLE, *supra* note 4, at 3. The savings would obviously be larger if the program were eliminated altogether.

Increasing public attention will surely be paid to the large taxpayer costs of the program once significant numbers of people begin to apply for and obtain forgiveness of six-figure debts that—in some instances—will exceed \$200,000. The Trump Administration's 2017 proposal to prospectively abolish the PSLF program<sup>43</sup> was never adopted, and the very similar 2019 Administration proposal will likely fail to be adopted as well. But as the major budgetary implications of forgiving this much debt become more clear, other attempts will likely be made by Congress, the Trump Administration, a later Administration, or all of them to statutorily limit PSLF program eligibility or its generosity in a retroactive manner, or to statutorily limit or eliminate the current exclusion of debt forgiven under this program from taxation.

As greater public attention is paid to the PSLF program, there may also be calls made for its elimination, or at least its curtailment or substantial modification, based not upon its overall costs but instead upon the regressive manner in which its benefits will be conferred. A typical undergraduate borrower who leaves school with a \$30,000 Direct Loan debt, takes a public service job of the nature and compensation level usually available to a person with only an undergraduate degree, and then enrolls in the popular Pay As You Earn ("PAYE") income-based loan repayment plan, will have \$25,000 of remaining debt to be forgiven after ten years of public service employment.<sup>44</sup> For such a borrower, the annualized value of the eventual debt forgiveness is approximately equal to an additional \$2,642 per year in before-tax income for that ten-year period.<sup>45</sup> This benefit provides a

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<sup>43</sup> See TRUMP PROPOSED BUDGET 2017, *supra* note 3, at 20 (proposing to abolish the PSLF program).

<sup>44</sup> Consider a person who graduates from an undergraduate program under the following typical circumstances: \$30,000 of Direct Loan debt; a 5% annual interest rate; a spouse and child; a qualifying public service position with a \$45,000 starting salary; and enrollment in the PAYE loan repayment plan. The plan will require the borrower to make annual repayments of only 10% of the difference between adjusted gross income and 150% of the poverty-level wage. Crespi (2014), *supra* note 26, at 79. The borrower's annual payment obligation would be approximately \$1,500. This would be just enough to meet the annual interest payments of \$1,500. In succeeding years, with modest annual raises and corresponding increases in annual payment obligations under the PAYE plan, the borrower would begin to amortize principal debt, but only by a few hundred dollars per year. After ten years, the borrower would still have \$25,000 or so of debt to be forgiven.

For an extended discussion of the financial details of the various federal income-based loan repayment plans and the tax consequences for borrowers of utilizing one of those plans without obtaining PSLF forgiveness, see Crespi (2014), *supra* note 26, 85–101 (detailing a hypothetical borrower's loan repayment under the IBR program). For further discussion of the taxation issues raised by these income-based loan repayment programs and discussion of the impacts of the Revised Pay As You Earn ("REPAYE") plan—the newest addition to the menu of subsidized loan repayment options—upon law school graduates, see Crespi (2017), *supra* note 25, at 337–49 (exploring why the REPAYE plan will have a limited impact on law school graduates); Crespi (2016), *supra* note 25, at 137–85 (addressing the impact of the tax bomb on lawyers).

<sup>45</sup> The annual benefit of \$25,000 in forgiven debt after ten years over a ten-year period at a 5% annual discount rate, is \$1,987 per year. Assuming that the typical public service worker is in a 25%



relatively modest inducement to enter public service—approximately an additional six percent each year for ten years—which is over and above the average initial public service compensation for persons with only undergraduate degrees.<sup>46</sup>

In sharp contrast, a typical law school graduate who leaves school with a now-common combined undergraduate and law school Direct Loan debt of \$150,000,<sup>47</sup> enrolls in the PAYE plan, and takes a public service position of the sort and compensation level open to recent law school graduates, will experience pronounced negative amortization of his loan debt during the next ten years. It is likely that this type of graduate will have \$200,000 of debt or more forgiven, almost an order of magnitude more than the typical undergraduate borrower.<sup>48</sup> Having \$200,000 of debt forgiven after ten years is approximately equivalent to receiving an additional \$21,142 per year in before-tax income each year for that ten-year period,<sup>49</sup> providing a much stronger inducement to enter public service. This is approximately equivalent to a thirty-eight percent raise each year over ten years, over and above the average initial public service compensation for law graduates each year.<sup>50</sup> A typical medical school graduate who also graduates with a \$150,000 loan debt, and who—as is common—spends the next seven years in modestly paid residencies and internships before taking a public service

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combined marginal federal and state income tax bracket, this would be \$2,642 per year in additional before-tax income.

<sup>46</sup>  $\$2642 / \$45,000 = 58.7\%$ . See *supra* notes 44, 45 (estimating a \$45,000 starting salary for a qualifying public service position and calculating an additional before-tax savings of \$2,642 for a person graduating from an undergraduate program).

<sup>47</sup> See *supra* note 40 (discussing the average amount of debt for undergraduate and law students).

<sup>48</sup> Consider a person who graduates from law school under the following typical circumstances: a combined undergraduate and law school Direct Loan debt load of \$150,000; a typical 6% annual interest rate, reflecting the higher rate charged to graduate school borrowers; a spouse and child; a qualifying public service position as an attorney with a \$55,000 starting salary; enrollment in the PAYE loan repayment plan. Under PAYE, the borrower will be required to make annual repayments of only 10% of the difference between adjusted gross income and 150% of the poverty-level wage. Crespi (2014), *supra* note 26, at 79. The borrower's annual payment obligation would be approximately \$2,500 per year. This would be far short of the amount needed—just enough to meet the annual interest payments on their loan debt of \$9,000. Their debt would therefore increase by \$6,500 during the first year. In succeeding years, with modest annual raises and corresponding increases in annual payment obligations under the PAYE plan, the amount of accruing unpaid interest would gradually reduce, but the negative amortization would likely persist for the entire ten-year period, leading to a total principal plus accrued interest debt of over \$200,000 at the time of debt forgiveness.

<sup>49</sup> Two-hundred thousand dollars of forgiven debt is eight times as large as the \$25,000 of forgiven debt for a typical undergraduate borrower. See *supra* text accompanying note 44 (calculating the typical forgiveness for an undergraduate student utilizing PSLF). If one annualizes the benefits of \$200,000 in forgiven debt after ten years over a ten-year period at a 5% annual discount rate, this comes to \$15,896 per year. Assuming that the typical legal public service worker is also in a 25% combined marginal federal and state income tax bracket, this would be \$21,142 per year in additional before-tax income.

<sup>50</sup>  $\$21,142 / \$55,000 = 38.44\%$ . See *supra* notes 48, 49 (estimating a \$55,000 starting salary for a qualifying public service position and calculating an additional before-tax savings of \$21,142 for a person graduating from law school).

position as a fully licensed doctor, will also experience pronounced negative amortization for most of the ten years of public service, and will have on the order of \$200,000 of debt forgiven.<sup>51</sup> This is, again, a benefit roughly equal to \$21,142 per year in additional before-tax compensation each year for ten years. The PSLF program has already come under harsh criticism for this regressive distributional feature and for distorting borrower incentives to favor high-cost graduate programs, even though very few such debts have been yet forgiven.<sup>52</sup>

The PSLF program could, without question, be prospectively limited or even terminated by statute with regard to those persons who have not yet taken out any Direct Loans at the time of legislative amendment, as the Trump Administration proposed in 2017 and again in 2019.<sup>53</sup> Those persons who have not yet executed any Direct Loan contracts at the time of a statutory amendment that curtailed PSLF program rights would clearly not be able to utilize the program to obtain forgiveness of later Direct Loan obligations beyond what forgiveness was permitted by that amendment, if at all. Nor would those persons who had previously taken out Direct Loans have a right to insist upon taking advantage of the pre-amendment PSLF program terms for any new Direct Loans that they may take out after such an amendment.

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<sup>51</sup> This medical school graduate with similar initial debt and family circumstances will be in essentially the same position as the law school graduate discussed above, *see supra* text accompanying note 39 (discussing the average median debt load of people who have obtained PSLF program employment certifications), except that the doctor would be likely to receive a substantial salary increase after completing an internship for the last three years of a ten-year public service period. This might even be enough to repay some of the accrued interest from the seven years of pronounced negative amortization. *See discussion supra* note 41.

<sup>52</sup> Jason Delisle argues that the fact that the PSLF program will disproportionately benefit high-debt graduate school borrowers will not only be improperly regressive in its incidence, but will also distort incentives to attend graduate school and encourage graduate schools to raise their tuitions. DELISLE, *supra* note 4, at 6–7. There has also been criticism of law schools encouraging their students to utilize the PSLF program as an indirect means of making those students less resistant to tuition increases. *See* Travis Hornsby, *Georgetown Law School PSLF Abuse Shows Why Program Will End*, STUDENT LOAN PLANNER (Dec. 19, 2016), <https://www.studentloanplanner.com/georgetown-law-school-pslf-abuse/> (arguing that PSLF became the largest back door grant program to American graduate schools in history).

On the other hand, law school graduates and doctors who enter public service rather than the private sector will, on average, make much larger financial sacrifices than those who enter public service with only undergraduate degrees, both in absolute dollar terms and in terms of the proportion of their alternative private sector salary forgone. Given this fact, a significantly larger financial inducement may be necessary to adequately encourage lawyers and doctors to enter public service than to induce persons with only undergraduate degrees to do so. This need for providing a stronger financial inducement for those with more attractive financial alternatives to public service may justify the regressivity and distorted incentives of the way that the debt forgiveness benefits of the PSLF program are allocated. There is room for reasonable disagreement here.

<sup>53</sup> *See* TRUMP PROPOSED BUDGET 2017, *supra* note 3, at 20 (proposing to abolish the PSLF program); TRUMP PROPOSED BUDGET 2019, *supra* note 23 (same).

The more difficult question is whether such statutory limitations, abolition, or tax changes could be retroactively imposed upon those who have not yet filed an application for PSLF forgiveness but have completed ten years of qualifying public service employment and executed loan documentation prior to the effective date of the new legislation.<sup>54</sup>

Answering this question will require two difficult determinations. First, do Direct Loan borrowers have contractual rights under their loan agreements to utilize the current PSLF program terms and favorable tax treatment of that forgiven debt for the loans they have taken out prior to any legislation that would change those terms? Second, if they do have those contractual rights to debt forgiveness and favorable tax treatment, is the federal government constitutionally permitted to retroactively abrogate those contractual rights through legislative amendments without providing compensation to those borrowers?

As to the first question, I will consider several related legal theories. One or more of these theories may support a claim by some who have taken out a Direct Loan to finance their education before the effective date of new legislation altering the PSLF program or favorable tax treatment. Such claimants might suggest that they have a contractual right to debt forgiveness in accordance with the PSLF program terms and perhaps also a contractual right to invoke the tax laws that were in force at the time that they took out their loan (at least those Direct Loans taken out prior to the effective date of new legislation). As to the second question, assuming for the sake of argument that the Direct Loan agreements do establish one or both of these borrower contractual rights under one or more legal theories, I will then consider whether the federal government has the power to legislatively abrogate one or both of those contractual rights without providing compensation.

The central loan document executed by borrowers under the federal Direct Loan program is titled “Master Promissory Note, Direct Subsidized Loans and Direct Unsubsidized Loans, William D. Ford Federal Direct Loan Program” (“MPN”).<sup>55</sup> That document provides the basis for each of four

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<sup>54</sup> An even more difficult question is posed by Direct Loans taken out after 1994 and before October 1, 2007. Those Direct Loans may be forgiven under the terms of the PSLF program, but there is no reference to the PSLF program in the MPN that was executed for those loans since the program had not yet been enacted. *See e.g.*, U.S. DEP’T OF EDUC., OMB No. 1845-0068, APPLICATION AND MASTER PROMISSORY NOTE: FEDERAL DIRECT PLUS LOAN WILLIAM D. FORD FEDERAL DIRECT LOAN PROGRAM, <https://ifap.ed.gov/dlbulletins/attachments/DLB0307B.pdf> (last visited Oct. 19, 2018) (illustrating that an MPN expiring in 2005 made no reference to PSLF). Whether these loans would provide borrowers with contractual protection against subsequent legislation curtailing PSLF rights to the same extent as would post-October 1, 2007 Direct Loans that reference the PSLF program is a hard question to answer; I suspect that they would not do so.

<sup>55</sup> The current MPN expires on April 30, 2019. U.S. DEP’T OF EDUC., OMB No. 1845-0007, MASTER PROMISSORY NOTE, DIRECT SUBSIDIZED LOANS AND DIRECT UNSUBSIDIZED LOANS, WILLIAM D. FORD FEDERAL DIRECT LOAN PROGRAM 1 (Oct. 21, 2018) [hereinafter MPN (2018)].

separate legal theories that I will consider as to why a borrower's execution of the document creates a contractual obligation for the government to provide the borrower with current PSLF rights and perhaps also the vested right to current tax law treatment.

The first legal theory that I will consider will be that the federal government, by making a Direct Loan to a borrower using loan documentation that refers to the PSLF program in the way that the MPN used since October 1, 2007, expressly provides borrowers with a contractual right to utilize the existing PSLF program terms and beneficial tax laws.<sup>56</sup> This argument may continue to be asserted even if the PSLF program or tax laws are legislatively altered and the loan documentation accordingly revised with regard to future Direct Loans.

The second and related theory that I will consider is that even if the MPN is interpreted to *not* expressly provide borrowers with the aforementioned contractual rights, under accepted contract law principles, borrowers still have an implied covenant of good faith and fair dealing with the government on their loan contracts. This implied covenant arguably protects borrowers' reasonable expectations to be able to invoke those PSLF terms and tax benefits in effect when they took out their loans.

The third argument that I will examine is that even if these borrowers have neither express contractual rights nor an implied covenant of good faith and fair dealing, they nevertheless can enforce their rights to favorable debt forgiveness and tax terms under the promissory estoppel theory of contractual liability based upon foreseeable reliance on the terms of their loan agreements.

Finally, I will consider the argument that if the three prior arguments fail, MPN terms that would allow unilateral imposition of harsher repayment terms or less favorable tax treatment are unconscionable and should therefore be excised from the loan agreements.

Having examined these potential arguments, I will then consider the government's arguments of why the government should be constitutionally permitted to retroactively abolish the PSLF program or tax benefits—even if borrowers are determined to have these contractual rights and especially if they do not.

This Article focuses solely upon the circumstances of Direct Loan borrowers with regard to subsequent statutory amendments that purport to retroactively curtail their PSLF program privileges or the tax law treatment of debt so forgiven. I will not consider in this Article possible attempts by the DOE to impose tighter limits on PSLF eligibility by adopting more restrictive new regulations that would narrow the scope of eligible public

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[https://studentloans.gov/myDirectLoan/downloadPDF.action?fileName=SUB\\_UNSUB\\_MPN](https://studentloans.gov/myDirectLoan/downloadPDF.action?fileName=SUB_UNSUB_MPN)  
[<https://perma.cc/AYA5-TMY2>].

<sup>56</sup> See I.R.C. § 108(f)(1) (2012) (excluding from the definition of gross income student loans discharged by reason of the student working for a certain period of time in certain professions).

service employment under the existing statutes rather than by statutory amendment. I will also not consider the possible DOE actions that would attempt to limit program eligibility through embracing a more restrictive interpretation of the current eligibility regulations. Obama Administration DOE actions of this latter nature from 2016 are being challenged in court by the American Bar Association.<sup>57</sup> I examine the merits of these challenges in a separate article.<sup>58</sup>

Let me provide the reader with a road map to the remainder of this Article. Part I presents the text of the relevant PSLF-program-related language that has been included since October 1, 2007 in the MPN for Direct Loan transactions. Part II explains why it is not yet possible to confidently offer precise estimates of the individual and aggregate amounts of loan debt that may possibly be forgiven under this program over the coming decades. However, a realistic hypothetical calculation based on the best data available will strongly suggest that the amount of debt forgiven under the PSLF program will eventually grow to at least \$12 billion per year, and perhaps to as much as \$18 billion per year, thus imposing substantial costs upon taxpayers. I will then discuss in Part III each of the contractual theories noted above that could be invoked by Direct Loan borrowers on the basis of the current MPN language and various theories of contractual liability. These arguments attempt to establish that students have a contractual right to later utilize current PSLF program terms and favorable tax treatment.

Part IV first considers the legality of retroactive abolition of the PSLF program and tax benefits, assuming Direct Loan borrowers are held to *not* have contractual rights to those favorable terms. I will then consider the legal consequences under the assumption that Direct Loan borrowers *do* have such contractual rights under one or another of the theories I have set forth.

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<sup>57</sup> The current DOE PSLF regulations broadly define which organizations will qualify as “public service organizations” whose employees may qualify for PSLF program debt forgiveness. 34 C.F.R. § 685.219(b) (2018). However, despite previously certifying for several prospective program applicants that their employment by the American Bar Association (“ABA”) would qualify as employment by a public service organization, the DOE under the Obama Administration (through FedLoan Servicing, an organization to whom the DOE has delegated PSLF program administrative responsibilities) later took the position that ABA employment will not qualify. Crespi, *supra* note 37, at 843. The DOE has since been sued by the ABA in the U.S. District Court for the District of Columbia in an attempt to reverse this ruling. Complaint for Declaratory and Injunctive Relief at 1–2, *Am. Bar Ass’n v. U.S. Dep’t of Educ.*, No. 16-cv-02476 (D.D.C. Dec. 20, 2016), 2016 WL 7634495. The DOE has taken a similar position regarding employment with both the American Civil Liberties Union and the American Immigration Lawyers Association, despite having previously certified both as qualifying for the PSLF program. Stephanie Francis Ward, *Did Government Reverse Position on Qualifications for Public Service Loan Forgiveness Program?*, ABA J. (June 16, 2016, 2:26 PM) [www.abajournal.com/news/article/did\\_doe\\_reverse\\_position\\_on\\_qualifications\\_for\\_public\\_service\\_loan\\_forgiveness](http://www.abajournal.com/news/article/did_doe_reverse_position_on_qualifications_for_public_service_loan_forgiveness). That lawsuit was recently resolved, with several, but not all, of the plaintiffs prevailing against the DOE. *Am. Bar Ass’n v. United States Dep’t of Educ.*, No. CV 16-2476 (TJK), 2019 WL 2211208 (D.D.C. May 22, 2019).

<sup>58</sup> See generally Crespi, *supra* note 37.

I will here assess the arguments that can be offered for and against the constitutionality of the federal government retroactively abrogating these contractual rights without providing compensation to affected borrowers. The final part of the Article will present my overall conclusions.

Let me briefly summarize these conclusions. First, as a matter of positive law, I believe that the express language of the MPN is most reasonably read as *not* creating contractual rights—neither for Direct Loan borrowers to later avail themselves of the current PSLF program privileges, nor to receive the current favorable tax treatment.<sup>59</sup> That being said, however, the argument that those borrowers have such contractual rights on the basis of the implied covenant of good faith and fair dealing is very plausible—at least for those borrowers who can demonstrate that they had a reasonable expectation at the time they took out their loan that they would have such rights.<sup>60</sup> In addition, the related but distinct argument that the government should be contractually bound by promissory estoppel principles to honor those debt forgiveness and tax treatment rights also has some force, again at least with regard to those borrowers who can demonstrate that they actually relied upon later having those rights at the time they entered into their loan agreements or when they later accepted public service employment. However, there are some strong counter-arguments against the application of promissory estoppel principles to create such contractual rights.<sup>61</sup> Finally, a robust unconscionability challenge can be mounted against enforcement of those MPN terms that make this debt forgiveness and favorable tax treatment only a privilege rather than a contractual right by subjecting those privileges to retroactive alteration—at least with regard to those high-debt borrowers who were unaware of or who did not understand this conditional language and who would be severely impacted by the loss or substantial curtailment of their debt forgiveness rights or their favorable tax treatment.<sup>62</sup>

Assuming Direct Loan borrowers do *not* have these two contractual rights, then the government *would* be permitted to retroactively abolish the PSLF program, mooted the issue of retroactively abolishing the tax exemption.<sup>63</sup> If one assumes for the sake of argument, however, that borrowers *do* have these contractual rights, the rights should be regarded as

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<sup>59</sup> See *infra* Part III(A) (suggesting that the express terms of the MPN do not preclude statutory amendments that could limit or eliminate PSLF debt forgiveness or the tax exemption for forgiven debt).

<sup>60</sup> See *infra* Part III(B) (noting that a court may ask a litigant to prove that he or she had a reasonable expectation of having contractual rights to debt forgiveness).

<sup>61</sup> See *infra* Part III(C) (explaining the promissory estoppel rationale and introducing the counter-arguments to using the promissory estoppel rationale).

<sup>62</sup> See *infra* Part III(D) (explaining the argument that contractual alterations here could be procedurally and substantively unconscionable).

<sup>63</sup> Which I believe would also then be permitted, although there are substantive due process concerns. See *infra* Part IV (introducing the due process issues).

“property” protected by the Takings Clause of the Constitution against statutory curtailment or elimination without payment of compensation raising some issues for the legality of abolishing the tax exemption.<sup>64</sup>

As a matter of policy, while I recognize that there is a sharp tension between the expectations of many current borrowers employed in public service to obtain debt forgiveness with favorable tax treatment, as against legitimate public concerns for the program’s excessive costs and regressive benefits,<sup>65</sup> I do not have strong feelings or special insights as to how this tension should be resolved. I would suggest for discussion one compromise resolution; continuing the program’s debt forgiveness benefits but adopting a statute which treats debt forgiven under the PSLF program as taxable income, as is now done for the other federal income-based loan repayment programs. There are, of course, other resolutions possible that might better balance these interests. The sooner these questions are resolved, the better for all concerned.

## I. THE DIRECT LOAN MASTER PROMISSORY NOTE

The following six provisions of the current MPN document used for making Direct Loans each explicitly or implicitly refer to the PSLF program. They are thus relevant to whether, by executing the MPN, a borrower secures contractual rights to debt forgiveness and tax exemption under current terms and law.<sup>66</sup>

### (1) GOVERNING LAW

The terms of this Master Promissory Note (MPN) will be interpreted in accordance with the HEA (20 U.S.C. 1070 et seq.), ED’s regulations, any amendments to the HEA and the regulations in accordance with the effective date of those amendments, and other applicable federal laws and regulations. Throughout this MPN, we refer to these laws and regulations collectively as the “Act[.]”<sup>67</sup>

### (2) REPAYMENT

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<sup>64</sup> See *infra* Part IV (expanding the argument that contractual rights should be regarded as property and protected under the Takings Clause).

<sup>65</sup> See *infra* Conclusion (noting the difficulty with balancing Direct Loan borrower’s reliance on the PSLF program with the public concern regarding the cost and regressive effect of the program).

<sup>66</sup> I have included the selective use of large bold font that is utilized by the Master Promissory Note.

<sup>67</sup> MPN (2018), *supra* note 55, at 3. The MPN includes multiple abbreviations, including “HEA” for the Higher Education Act of 1965 and “ED” for the Department of Education.

You must repay the full amount of the loans made under this MPN, plus accrued interest.<sup>68</sup>

(3) William D. Ford Federal Direct Loan Program  
Direct Subsidized Loan and Direct Unsubsidized Loan  
Borrower's Rights and Responsibilities Statement

IMPORTANT NOTICE

This Borrower's Rights and Responsibilities Statement provides additional information about the terms and conditions of the loans you receive under the accompanying Master Promissory Note (MPN) for Direct Subsidized Loans and Direct Unsubsidized Loans.<sup>69</sup>

(4) LAWS THAT APPLY TO THIS MPN

The terms and conditions of loans made under this MPN are determined by the HEA and other applicable federal laws and regulations. These laws and regulations are referred to as "the Act" throughout this Borrower's Rights and Responsibilities Statement . . . .

NOTE: Any amendment to the Act that affects the terms of this MPN will be applied to your loans in accordance with the effective date of the amendment.<sup>70</sup>

(5) DISCHARGE (HAVING YOUR LOAN FORGIVEN)

. . . .

Public Service Loan Forgiveness

A Public Service Loan Forgiveness (PSLF) program is also available. Under this program, we will forgive the remaining balance due on your eligible Direct Loan Program loans after you have made 120 payments on those loans (after October 1, 2007) under certain repayment plans while you are employed full-time in certain public service jobs. The required 120 payments do not have to be consecutive. Qualifying

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<sup>68</sup> *Id.* at 4.

<sup>69</sup> *Id.* at 6.

<sup>70</sup> *Id.*



repayment plans include the REPAYE Plan, the PAYE Plan, the IBR Plan, the ICR Plan, and the Standard Repayment Plan with a 10-year repayment period.<sup>71</sup>

#### (6) PROMISE TO PAY

....

By signing this MPN, you . . . agree to repay in full all loans made under this MPN according to the terms and conditions of the MPN.<sup>72</sup>

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The MPN makes no reference to Section 108 of the IRS Code, which provides an exemption from inclusion in taxable income for student loan debt that is forgiven under the PSLF program.<sup>73</sup>

### II. THE AMOUNT OF DEBT LIKELY TO BE FORGIVEN UNDER THE PSLF PROGRAM

The data is, unfortunately, currently inadequate to offer precise estimates of how many people will take advantage of the generous PSLF provisions in the coming tax years. Before the program was first established in 2007, the Congressional Budget Office estimated that, if the then-proposed PSLF legislation was adopted, “approximately 50,000 new borrowers each year would eventually be eligible for, and participate in, income-contingent loan forgiveness” under this program.<sup>74</sup> But this early, pre-enactment estimate was little more than a guess, and it will likely prove to be a significant underestimate. A million borrowers have obtained annual employment certifications as of the end of the third quarter of 2018,<sup>75</sup> with 197,496 new borrowers doing so during the first nine months of 2018 alone<sup>76</sup> even though such certifications are not required.<sup>77</sup> It has been estimated that

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<sup>71</sup> *Id.* at 13.

<sup>72</sup> *Id.* at 14.

<sup>73</sup> See I.R.C. § 108(f)(1) (2012) (excluding from the definition of gross income student loans discharged by reason of the student working for a certain period of time in public service professions).

<sup>74</sup> H.R. REP. NO. 110-210, at 72 (2007).

<sup>75</sup> As of the end of the third quarter of 2018, a total of 999,536 borrowers have had at least one employment certification application approved. ECF REPORT (2018), *supra* note 29.

<sup>76</sup> See *id.*

<sup>77</sup> DELISLE, *supra* note 4, at 3 (noting that the certification process is optional). Of these certifications, approximately 62% of the applicants were employed by a governmental body and 38% by a qualifying Section 501(c)(3) organization. Hoblitzell et al., *supra* note 39, at 23. Approximately 70% of the applications for certification were granted, and the remainder were denied either because the

as many as one-quarter of the jobs in the economy qualify as public service jobs under the program's broad definition.<sup>78</sup>

The data is also inadequate to precisely estimate the average amount and range of the debts that will be forgiven each year. The Congressional Budget Office annual participation estimate noted above did not include any estimates of the aggregate amount of debt that would be forgiven each year.<sup>79</sup> Many PSLF participants will have only modest undergraduate debt and no graduate school debt,<sup>80</sup> and thus they will likely have relatively small amounts of debt left to be forgiven. But according to estimates, because of substantial participation by high-debt graduate school borrowers, the median debt load of participants at the time of debt forgiveness could be over \$60,000, with nearly 30% of participants having debt loads of over \$100,000.<sup>81</sup> In addition, 2014 data revealed that 80% of Direct Loan borrowers who had received one or more annual PSLF employment certifications had debts of over \$30,000, compared to only 36% of all Direct Loan borrowers.<sup>82</sup>

Many law school and medical school graduates leave school with six-figure combined graduate and undergraduate student debt loads,<sup>83</sup> and those lawyers and doctors who take public service jobs paying relatively modest salaries often will experience significant negative amortization of these debts over the following decade. The monthly loan repayments that they will have to make under either the PAYE plan or the post-2014 version of the Income-Based Repayment plan—one of which is usually selected by persons in this position—will be based in size upon their relatively modest salaries and will normally not be sufficient to cover even the interest owing on those large loan debts.<sup>84</sup> This will lead to negative amortization and rapid growth of their unpaid debt. Many will consequently have accumulated debt of upwards of \$200,000 or more<sup>85</sup> to be forgiven after ten years of qualifying employment. The forgiveness of these numerous large individual loan debts

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employer did not qualify, the loans involved were not eligible for forgiveness, or there was missing or incorrect information on the application. *Id.* at 24–25.

<sup>78</sup> See GAO-15-663, *supra* note 37, at 27 (discussing how an estimated 24.7% of U.S. workers were employed in PSLF-qualifying public service jobs based on 2012 employment data from the Bureau of Labor Statistics).

<sup>79</sup> H.R. REP. NO. 110-210, at 71–72 (2007).

<sup>80</sup> See DELISLE, *supra* note 4, at 4 (noting that dependent undergraduate borrowers are only permitted to borrow \$31,000 over five years of education, and independent borrowers are permitted to borrow \$57,500).

<sup>81</sup> *Id.* (drawing on Hoblitzell et al., *supra* note 39, at 28).

<sup>82</sup> GAO-15-663, *supra* note 37, at 30–31.

<sup>83</sup> See Crespi (2016), *supra* note 25, at 154–55 n.110 (calculating that the average law school debt from 2011 to 2014 would be approximately \$160,000).

<sup>84</sup> See *id.* at 123–24 (explaining how payments are calculated under each plan).

<sup>85</sup> *Id.* at 163.

could easily impose a substantial annual cost upon the U.S. Treasury in the billions of dollars.<sup>86</sup>

Precisely how many billions of dollars per year in costs to taxpayers is unclear, but a few things are certain: at least 24.9 million, and perhaps as many as 31.9 million, borrowers have taken out Direct Loans since October 1, 2007, incorporating the current MPN provisions set forth above that relate in some fashion to the PSLF program;<sup>87</sup> a million of these borrowers have filed at least one of the voluntary PSLF program employment certification forms with the DOE,<sup>88</sup> and roughly one-quarter of all jobs will qualify as public service jobs.<sup>89</sup> But since there is no requirement that people register for the PSLF program prior to eventually filing for debt forgiveness when they become eligible to do so, there is no solid basis for forecasting how many borrowers will eventually apply, nor how large the aggregate amount of debt forgiven will likely be. But given: (1) how attractive the debt forgiveness terms of the PSLF program are, particularly for high-debt graduate school borrowers; (2) how broadly public service employment is defined for PSLF program purposes; and (3) the fairly large and rapidly increasing number of annual employment certification forms that have been filed to date, the amount of debt forgiven each year under this program will eventually become quite substantial,<sup>90</sup> likely large enough to lead to political efforts to limit or even end the PSLF program.<sup>91</sup>

To make these impending financial consequences for taxpayers clearer, consider the following illustrative, realistic hypothetical calculation. In 2015, 143,276 new borrowers first received annual employment certifications from the DOE, and in 2016, a total of 218,223 new borrowers first received annual employment certifications.<sup>92</sup> In 2014, the number of

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<sup>86</sup> DELISLE, *supra* note 4, at 3.

<sup>87</sup> *Federal Student Aid Portfolio Summary*, *supra* note 12 (illustrating that between the end of 2007 and 2017, 26 million Direct Loan borrowers had taken out their loans, and seven million additional Direct Loan borrowers had outstanding loans as of fiscal year 2007). In addition, as of 2011, there were 23.8 million persons with outstanding FFELP loans under that loan program, which was discontinued in 2010, and 2.9 million persons with outstanding Perkins loans. *Id.* Some significant proportion of these borrowers have or will later consolidate those loans into Direct Loans eligible for PSLF program debt forgiveness. For a more thorough discussion regarding the eligibility of FFELP loans and Perkins loans for PSLF, see *supra* note 12.

<sup>88</sup> See ECF REPORT (2018), *supra* note 29 (noting that as of the fourth quarter of 2018, a total of 999,536 borrowers have had at least one employment certification application approved).

<sup>89</sup> See GAO-15-663, *supra* note 37, at 27 (observing that an estimated 24.7% of U.S. workers were employed in PSLF-qualifying public service jobs based on 2012 employment data from the Bureau of Labor Statistics).

<sup>90</sup> See *supra* notes 40–41 and accompanying text (discussing the substantial student loan debts associated with legal and medical education).

<sup>91</sup> See *supra* notes 19–23 and accompanying text (explaining that the Trump Administration already attempted to impose limitations on the PSLF program with its 2017 budget proposal).

<sup>92</sup> *Supra* notes 31–32.

Direct Loan borrowers increased by 2.3 million;<sup>93</sup> in 2015, by 2 million;<sup>94</sup> and in 2016, by 1.6 million.<sup>95</sup> These figures together suggest that upwards of a couple of hundred thousand people each year, or more, may now be entering the PSLF program loan forgiveness ten-year “pipeline.”<sup>96</sup> Another important statistic to consider is that approximately 1.31 million<sup>97</sup> Direct Loan borrowers currently work in public service positions and have enrolled in an income-based loan repayment plan, making them likely to have some unpaid loan debt after ten years of public service. One would expect that on average about 10% of these 1.31 million persons will reach the ten-year PSLF employment requirement each year over the next decade, an average of approximately 131,000 people each year, with, as I have noted, approximately 200,000 or more newly hired public service employees now entering the ten-year “pipeline” each year and working towards eventual debt forgiveness eligibility.

I will (rather conservatively, I believe) project for the sake of this numerical illustration that the eventual “steady-state” number of persons who will seek debt forgiveness each year under the PSLF program will stabilize at approximately 200,000.<sup>98</sup> I base my projection on the data regarding the number of new Direct Loan borrowers each year, the revealed extent of PSLF program interest through filings for annual employment certification, and the number of existing Direct Loan borrowers who both are public service employees and are enrolled in income-based loan repayment programs.

How much debt will be forgiven if this many people obtain forgiveness each year? The median amount of Direct Loan debt for persons who will later seek debt forgiveness under the PSLF program has been estimated at

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<sup>93</sup> See FED. STUDENT AID, U.S. DEP’T OF EDUC., FEDERAL STUDENT AID PORTFOLIO SUMMARY (2018), <http://studentaid.ed.gov/sa/about/data-center/student/portfolio> (last visited Oct. 1, 2018) (presenting the number of Direct Loan borrowers from 2013–2018).

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> These recent figures, showing that the number of persons filing for annual employment certifications by 2016 is more than 10% of the number of annual new Direct Loan borrowers, suggest that the proportion of the approximately one-quarter of Direct Loan borrowers who will take public service positions—and eventually seek PSLF program loan forgiveness—is now in the neighborhood of 40%.

<sup>97</sup> As of the third quarter of 2016, approximately 21.8 million people were repaying Direct Loans, and approximately 24%—5.23 million people—were enrolled in income-based repayment plans. GAO 17-22, *supra* note 37, at 9. Assuming, conservatively, that approximately 25% of those persons were employed in public service jobs, that amounts to 1.31 million people.

<sup>98</sup> Given: (1) that prior employment certifications are not required for debt forgiveness eligibility; (2) an estimated one-quarter of all employment would qualify for the PSLF program; and (3) the rapidly rising proportion of Direct Loan borrowers enrolling in income-based loan repayment plans, this 200,000 number may well be a conservative under-estimate of the number of people who will annually seek debt forgiveness. DELISLE, *supra* note 4, at 3.

slightly over \$60,000.<sup>99</sup> I will assume for this simple illustration that the average amount of Direct Loan debt owed by these persons upon their enrollment in one or another of the loan repayment plans is equal to this median debt estimate.<sup>100</sup> Most of those persons will have spent the next ten years after leaving school enrolled in either the PAYE plan or the post-2014 version of the Income-Based Repayment plan. Under either plan, they will only have had to make loan repayments equal to 10% of their disposable income,<sup>101</sup> and given that the annual income for most persons working in qualifying public service jobs will be relatively modest, those loan repayments will on average barely be large enough to cover the annual loan interest charges,<sup>102</sup> if that, leaving on average the entire debt principal unpaid at the time debt forgiveness is sought. Two-hundred thousand people per year with an average of \$60,000 each of loan debt forgiven,<sup>103</sup> without tax consequences, comes to \$12 billion per year of forgiven debt—a substantial cost to the Treasury.

This estimate of the annual steady-state PSLF program costs to the Treasury, strikingly large as it is, may well be too conservative. With two million new borrowers each year,<sup>104</sup> one-quarter of all jobs qualifying for the program,<sup>105</sup> and rapidly increasing enrollment in income-based loan

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<sup>99</sup> See *id.* at 4.

<sup>100</sup> Given that there is a “long right tail” of law school or medical school Direct Loan borrowers with very large loan debts, the average amount of initial loan debt owed by persons who will eventually obtain PSLF forgiveness may well exceed the estimated median debt load of \$60,000. See *id.* (depicting graphically the long right tail of loan balances and explaining that it is because “the program is dominated by students who attended graduate and professional school”).

<sup>101</sup> Consider, for example, a Direct Loan borrower with a spouse and child who takes a \$60,000 initial loan debt at a typical average annual interest rate of 6% and a public service position starting at a \$50,000 salary. Under the PAYE plan that person would have to make annual loan repayments of 10% of their disposable income, approximately \$3,000. This would be somewhat less than \$3,600 annual interest charge on their loan, leading to a \$600 annual increase in their debt. With modest annual salary increases, loan repayments would correspondingly increase, gradually allowing the borrower to be able to slightly amortize the debt. After ten years, the remaining debt would likely be quite close to the initial debt. For a high-debt law school or medical school borrower, however, there would be substantial negative amortization throughout most or all of the ten-year period, leading to a forgiven debt well in excess of the original substantial loan amount.

<sup>102</sup> A person who is under the PAYE plan paying only 10% of the disposable income portion of, for instance, a typical \$50,000–\$60,000 public interest salary would at best barely be able to cover the interest payments on the median \$60,000 debt load. See Sam Halpert, *New Public Service Attorney Salary Figures from NALP Show Slow Growth Since 2004*, NALP: PUBLIC INTEREST SALARIES (July 9, 2018), <https://www.nalp.org/publicsectorsalaries> (discussing average salaries for public sector attorneys based on a nationwide survey).

<sup>103</sup> *Supra* note 100; see also DELISLE, *supra* note 4, at 4 (explaining how the PSLF program has borrowers with “some of the highest loan balances in the federal student loan program”).

<sup>104</sup> See *supra* note 38 (calculating that there will be approximately 1.89 million Direct Loan Borrowers under PSLF each year); GAO-17-22, *supra* note 37, at 1 (explaining the plan to add two million new borrowers).

<sup>105</sup> DELISLE, *supra* note 4, at 3.

repayment plans,<sup>106</sup> the long-run steady-state rate of participation in this program could significantly exceed 200,000 persons per year leading to even higher costs for taxpayers, particularly once the program's benefits become more widely bestowed and publicized. If, for example, 15% of each year's approximately two million Direct Loan borrowers later utilize the program (still significantly less than the approximately 25% of jobs which qualify as public service jobs),<sup>107</sup> that would lead to approximately 300,000 persons per year seeking debt forgiveness, at a total annual cost of approximately \$18 billion.

I am certain that annual costs of \$12 billion to \$18 billion will lead to political efforts to statutorily curtail or eliminate the PSLF program, probably resulting in broad support for retroactive changes impacting both existing and future borrowers, if this can be legally justified. These efforts will be bolstered by the support of those persons who are primarily concerned by the highly regressive nature of the program's benefits in favor of high-debt law school and medical school graduates with above-average incomes that I have noted. Let me now turn to the legality of the retroactive application of such statutes, were they to be adopted.

### III. BORROWER CONTRACTUAL RIGHTS TO INVOKE DEBT FORGIVENESS

The United States government is subject to the same obligation to perform its contractual obligations as are private parties, except in those few instances where special sovereign immunity defenses apply.<sup>108</sup> Such defenses do not apply to ordinary student loan transactions.<sup>109</sup> The issue here is therefore whether the MPN documentation that is now used for Direct Loan transactions contractually obligates the government to provide borrowers with those PSLF program debt forgiveness provisions and the related tax laws that existed when the contracts were entered into, and if so, whether these borrower contractual rights are constitutionally protected from being abrogated by later-enacted changes in those laws.

Let me consider separately each of four different rationales that can be offered in support of the argument that Direct Loan borrowers who took out their loans after October 1, 2007 and prior to the effective date of any legislative changes affecting the PSLF program or related tax laws have a contractual right both to invoke the program's terms and related tax laws in force at the time that they took out their loans. These four arguments are based on: (1) the express terms of the MPN; (2) the implied covenant of good faith and fair dealing; (3) promissory estoppel and the borrower's foreseeable reliance on later being able to invoke the PSLF program's terms

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<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> *Perry v. United States*, 294 U.S. 330, 351 (1935) (citing *Sinking-Fund Cases*, 99 U.S. 700, 719 (1878)).

<sup>109</sup> See 28 U.S.C. § 1491(a)(1) (2012) (listing sovereign immunity defense exceptions).

and related tax benefits; and (4) unconscionability of MPN terms that would retroactively subject borrowers to later-enacted legislative changes in the program. In Part V, I will start with the assumption that these contractual rights can be established under one or more of these theories, and I will then turn to consider whether the federal government could legally adopt statutes abrogating one or both of these rights without being subject to constitutional limitations that would either bar such actions or require it to provide compensation to those borrowers.

#### A. *The Express Contractual Terms Argument*

The MPN clearly states the terms of the debt forgiveness rights that borrowers currently have under the PSLF program.<sup>110</sup> However, the MPN also appears to incorporate by reference later-enacted laws that could retroactively curtail or even eliminate those borrower rights. For example, the MPN states that “the terms of this Master Promissory Note (MPN) will be interpreted in accordance with . . . amendments to the HEA [in which the PSLF program authorization is embedded] and the regulations in accordance with the effective date of those amendments, and any other applicable federal laws and regulations.”<sup>111</sup> The MPN then similarly states in bold font that “any amendment to [the HEA] that affects the terms of this MPN will be applied to your loans in accordance with the effective date of the amendment.”<sup>112</sup>

One could argue that this language should be interpreted as justifying the incorporation of statutory amendments only into new Direct Loans that are taken out after the effective date of those amendments—not into prior loans. But this argument will face considerable difficulties. The several references to “this MPN” in the statutory incorporation language noted above strongly suggest that statutory amendments to the Higher Education Act or its implementing regulations will also apply retroactively, impacting the rights and duties created under earlier loan agreements. Whether amendments to federal laws and regulations other than the Higher Education Act, such as the tax laws, would apply retroactively is less clear.<sup>113</sup> My conclusion here is that if one considers only the express terms of the MPN and not any duties of good faith and fair dealing that would be implied into the loan contracts to supplement those express terms, nor any additional lender contractual duties that may be based upon foreseeable borrower reliance on the loan terms, nor any possible unconscionability-based reformation of the loan terms (which arguments are each discussed more

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<sup>110</sup> See MPN (2018), *supra* note 55, at 8 (explaining the right to forgiveness under PSLF after 120 payments have been made, if employed full-time in certain public service jobs).

<sup>111</sup> *Id.* at 3.

<sup>112</sup> *Id.* at 6.

<sup>113</sup> See *id.* at 6 (noting that the terms and conditions of a loan under the MPN are determined “by the HEA and other applicable federal laws and regulations”).

fully below), those MPN terms appear to *not* preclude retroactive application of statutory amendments that would limit or eliminate current PSLF program debt forgiveness privileges or the current tax exemption of forgiven debt for Direct Loan borrowers who took out those loans prior to the effective date of those amendments.

In other words, under the express terms of the MPN these Direct Loan borrowers would not have contractual rights that could not be unilaterally modified or rescinded by statute. Let me note here that there is a reasonable case to be made that the express terms of the MPN are not clear enough to permit the retroactive imposition of statutory limitations of PSLF program debt forgiveness rights or the imposition of less favorable tax treatment for forgiven debt. That argument has some plausibility and appeal given the vagueness and generality of the references to possible later-enacted statutes in the MPN. But in my opinion, it is not likely to prevail.

The DOE in its 2008 regulations implementing the PSLF program rather summarily also took the position that the express terms of the MPN do not provide Direct Loan borrowers with a contractual right to invoke the program's debt forgiveness terms.<sup>114</sup> A later short 2016 study by the AccessLex Institute also reached the same conclusion.<sup>115</sup> Finding support in the express MPN terms for vested borrower rights that are not subject to legislative abridgement appears to be an uphill struggle. However, there are at least three other promising contract law avenues to explore, one or more of which may suffice to establish contractual borrower rights to debt forgiveness and favorable tax treatment thereof, at least for a subset of Direct Loan borrowers if not all of them. None of these alternative theories of

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<sup>114</sup> This position appears in the "discussion" published with the final rule:

With regard to incorporating a description of the public service loan forgiveness benefit in the MPN, the Department is already taking steps to refer to the program in the MPN and other program documents. However, the MPN will continue to state, as it currently does, that the terms and conditions of the loans are subject to the HEA as it is amended in accordance with the effective date of those amendments. Although there is no history in the program of Congress eliminating or reducing a borrower benefit, the Department does not believe that a reference to the public service loan forgiveness program in the MPN would provide the borrower with a contractual right to the benefit should Congress take action to eliminate that benefit from the HEA as of a particular effective date.

Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 73 Fed. Reg. 63232, 63242 (Oct. 23, 2008).

<sup>115</sup> See *Policy Analysis: Impact of Potential Changes to Public Service Loan Forgiveness Program*, ACCESSLEX INSTITUTE 2 (2016), <https://www.accesslex.org/index.php/policy-analysis-impact-of-potential-changes-to-public-service-loan-forgiveness-program> ("[T]he MPN does not appear to provide any contractual rights on its face that protect against the qualifying terms and conditions . . . being modified prior to the satisfaction of the 120-payment requirement. In fact, the MPN provides clear notice that any amendments to the HEA will be incorporated into the terms of the MPN.").



contractual obligation appear to have been considered by either the DOE or the AccessLex Institute. Let me turn to these alternative theories.

*B. The Implied Covenant of Good Faith and Fair Dealing Argument*

As discussed above, the express terms of the current MPN should, and probably would, be interpreted to not impose any contractual obligation on the federal government to allow existing Direct Loan borrowers the benefit of current PSLF terms<sup>116</sup> or favorable tax laws.<sup>117</sup> Nevertheless, there is case law holding the government liable for breach of contract, even absent violation of any express contractual terms, on the basis of an implied covenant of good faith and fair dealing.<sup>118</sup> In *Centex v. United States*, for example, the Federal Circuit Court of Appeals held that this covenant was implied into governmental contracts with a private party, and that the covenant imposed a duty upon the government “not to act so as to destroy the reasonable expectations of the other party as to the fruits of the contract.”<sup>119</sup>

This implied covenant of good faith and fair dealing therefore imposes limits on the ability of the government to retroactively alter the terms of Direct Loan agreements by statute. For example, consider the extreme situation that would be presented by the passage of a statute that unilaterally increased the fixed interest rate on previously executed Direct Loans by a significant amount above the rate to which the borrowers had agreed. Such a statute would technically conform to the express MPN terms that arguably allow, without restriction, statutory changes with retroactive impacts on loan terms.<sup>120</sup> However, such an attempt by the government to unilaterally impose a much higher interest rate on prior borrowers than what was originally agreed to would surely be regarded by the courts as contrary to the reasonable expectations of typical borrowers—specifically, that their interest payment obligations under a nominally fixed interest rate loan agreement would remain unchanged for the term of the loan. It would therefore be in violation of the implied covenant of good faith and fair dealing. Another way to state this conclusion would be to say that the borrowers have an implied contractual right to be charged no more than the originally agreed interest rate.

In a similar fashion, for those many borrowers who have large student loans and who later take relatively low-paying qualifying public service jobs, such as many law school and medical school graduates, either the

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<sup>116</sup> See *supra* Section III.A.

<sup>117</sup> See *supra* text accompanying note 45 (explaining the tax consequences under the current PSLF).

<sup>118</sup> *Centex Corp. v. United States*, 38 F.3d 1283, 1306 (Fed. Cir. 2005).

<sup>119</sup> *Id.* at 1304.

termination of PSLF privileges or the elimination of the tax exemption for forgiven debt under this program, would have severe adverse financial consequences that would be economically equivalent to a rather large unilateral increase in their fixed interest payment obligations.<sup>121</sup> Such statutes should arguably be judicially regarded in a similar manner as being a violation of the borrowers' contractual rights created by that implied covenant.

Despite the express MPN language that is arguably textually sufficient to allow retroactive incorporation of later legislative enactments,<sup>122</sup> the typical student loan borrower does not (and probably could not) give the fine print of the extensive and detailed MPN loan documentation the close, lawyerly reading that would reveal such risks.<sup>123</sup> The typical Direct Loan borrower is young and financially relatively inexperienced and gives detailed loan documentation only a cursory reading at best before signing it.<sup>124</sup> Those typical borrowers would generally expect (and would arguably be reasonable in doing so) that not only would their initial fixed interest payment obligations remain unchanged, but that they would also be able to later avail themselves of the PSLF program's debt forgiveness terms and the relevant tax law provisions that existed at the time of their loan. The substantial curtailment or elimination of those debt forgiveness terms or tax benefits would be just as devastating to them as would be a large unilateral interest rate increase. They might understand that later-enacted statutes could impact their subsequent disclosure or other technical regulatory compliance obligations in some fashion, perhaps significantly increasing their burdens in these regards, but they would probably not anticipate that

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<sup>121</sup> For example, consider a law school graduate with a (not unusual) \$150,000 combined undergraduate and graduate student debt load at an average 7% annual interest rate who took a qualifying \$50,000 per year public service job and enrolled in the PAYE repayment plan. If one assumes a typical disposable income of approximately \$30,000 per year, this person would repay approximately only \$3,000 per year under the PAYE plan and owe \$225,000 after ten years of payments due to the significant negative amortization (without capitalization of the unpaid interest) of their \$10,500 annual interest payment obligations on the loans. If the PSLF program was statutorily abolished retroactively to require continuing repayment of at a 7% interest rate, this additional burden of \$225,000 would be the economic equivalent of a very high initial interest rate on the original \$150,000. Even only the lesser change of removing the tax exemption for debt forgiven under the PSLF program would impose on that graduate a large one-time tax bill of approximately \$75,000—a significant burden indeed for most people who have worked for at least ten years in modestly compensated public service positions.

<sup>122</sup> See MPN (2018), *supra* note 55, at 3 (“The terms of this Master Promissory Note (MPN) will be interpreted in accordance with the HEA . . . , ED’s regulations, any amendments to the HEA and the regulations in accordance with the effective date of those amendments, and other applicable federal laws and regulations.”).

<sup>123</sup> See Amanda Harmon Cooley, *Promissory Education: Reforming the Federal Student Loan Counseling Process to Promote Informed Access and to Reduce Student Debt Burdens*, 46 CONN. L. REV. 119, 121 (2013) (stating that most student loan borrowers do not carefully consider “the legal obligations that they accept as conditions to receiving student loan funds”).

<sup>124</sup> *Id.* at 121–22.

statutory changes might be retroactively imposed on their loan agreements that would radically and adversely alter its basic financial parameters.

It is possible that a court determining whether Direct Loan borrowers had contractual rights to debt forgiveness and current tax benefits, in the face of an attempted statutory curtailment of those privileges, might elect to apply the “reasonable expectations” criterion under this implied covenant to the particular litigants before the court.<sup>125</sup> It might do so in a fact-specific manner rather than in a more conventional “objective” manner based on hypothetical average contracting party characteristics, even though the latter approach is quite commonly used in many contexts for legal assessment of the “reasonableness” of conduct. Rather than postulating a hypothetical reasonable borrower and then determining whether that hypothetical person had a reasonable expectation of debt forgiveness and favorable tax treatment meriting protection of contractual rights, the court might require the litigant before it to provide sufficient subjective evidence that he or she did in fact have reasonable expectations of having a contractual right to debt forgiveness, and a right to the current favorable tax treatment thereof.

Under this judicial approach, litigants asserting that they had these contractual rights under the MPN’s implied covenant of good faith and fair dealing would have the considerable burden of providing sufficient evidence to establish a favorable position on each of six legal issues: (1) whether they were aware of the PSLF program debt forgiveness terms set forth in the MPN when they executed their loan documents; (2) if so, whether they expected that their rights to utilize those debt forgiveness terms would survive a later legislative amendment that would attempt to curtail those rights; (3) if so, whether such expectations were reasonable given their degree of legal sophistication; (4) whether they were aware when they executed their loan documents of the favorable tax treatment accorded to debt forgiven under the PSLF program; (5) if so, whether they expected that their rights to invoke those tax benefits would survive a later legislative amendment that would attempt to curtail those rights; and (6) if so, whether such expectations were reasonable given their degree of legal sophistication.

Under such a fact-specific “reasonable expectations” inquiry, only those persons who could satisfy the first three issues noted above by providing sufficient evidence that they were aware of the current PSLF program debt forgiveness benefits, and that they reasonably expected those benefits to be contractual rights, would be accorded a contractual right to those benefits. In similar fashion, only those persons who could satisfy the second three issues noted above by providing sufficient evidence that they were aware of the favorable tax treatment of debt forgiven under the PSLF programs, and

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<sup>125</sup> See *Reasonable-Expectations Doctrine*, BLACK’S LAW DICTIONARY (10th ed. 2014) (“The principle that an ambiguous or inconspicuous term in a contract should be interpreted to favor the weaker party’s objectively reasonable expectations from the contract, even though the explicit language of the terms may not support those expectations.”).

that they reasonably expected those tax terms to be contractual rights, would be accorded a contractual right to that tax treatment.

A judicial requirement for such fact-specific showings would be devastating to the implied covenant argument for most borrowers. These fact-heavy inquiries regarding each of perhaps numerous loan transactions taking place as long as ten years earlier could be made by at most only a small proportion of those borrowers. This requirement would probably, as a practical matter, be tantamount to rejecting the argument that these two contractual rights exist on the basis of the implied covenant of good faith and fair dealing.

There are clear advantages of judicial economy of making a single blanket ruling on this question of the existence of implied covenant-based contractual rights that would apply equally to all Direct Loan borrowers. For example, this blanket ruling would avoid the need for a great deal of fact-specific litigation as to the understandings and intent of specific borrowers, and thus a court might be willing to make this “reasonable expectations” determination on the “objective” criteria of a hypothetical “average” Direct Loan borrower.<sup>126</sup> If so, that court might conclude that the hypothetical borrower was aware of and expected to be able to invoke the PSLF program’s debt forgiveness terms and that these expectations were reasonable, thus recognizing contractual rights under the implied covenant of good faith and fair dealing.

This “objective reasonable expectations” argument would be less powerful in establishing a contractual right that would preclude the retroactive application of a change in the IRS Code that would limit or eliminate the favorable tax treatment of forgiven debt under the PSLF program. The MPN refers explicitly to the PSLF program’s debt forgiveness benefits but makes no explicit reference to the favorable tax treatment of that forgiven debt that would make borrowers aware of those benefits or set expectations that those benefits would be available years later, at the time of debt forgiveness.<sup>127</sup> In addition, given the general broad judicial acceptance (and reasonably wide public recognition) of the view that amendments to the IRS Code that have adverse retroactive effects upon particular taxpayers are permitted,<sup>128</sup> an argument can be made that any expectations that the relevant tax laws will remain unchanged are unreasonable and should not be judicially protected.

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<sup>126</sup> See *supra* notes 101–02 and accompanying text (describing the average loan borrower).

<sup>127</sup> See MPN (2018), *supra* note 55, at 13 (detailing PSLF loan forgiveness).

<sup>128</sup> See, e.g., *United States v. Carlton*, 512 U.S. 26, 27, 32 (1994) (holding that the retroactive application of a federal tax amendment did not violate the Due Process Clause of the Fifth Amendment).

### C. *The Promissory Estoppel Argument*

If the implied covenant of good faith and fair dealing argument is held to be too narrow to provide contractual rights to debt forgiveness current tax benefits, the essence of the argument set forth above can be presented in a slightly different guise. Another legal doctrine which might provide contractual protection for borrower expectations is the broadly accepted doctrine of promissory estoppel.<sup>129</sup>

Under the promissory estoppel principle, if (1) the government should “reasonably expect” that a Direct Loan borrower would rely upon a promise of later availability of the current PSLF program debt forgiveness terms and their favorable tax treatment, and (2) the borrower does so rely, either in taking out the loan or in later accepting public service employment, then the government will have to recognize the borrower’s contractual right to invoke those terms to the extent “justice requires.”<sup>130</sup> The focus of the inquiry here would be whether the *government* should reasonably expect borrower reliance upon the later availability of those terms, rather than upon the reasonableness of the *borrowers’* expectations in relying upon those terms, which would be the focus of the implied covenant of good faith and fair dealing inquiry discussed above. If the court were to determine that the government should reasonably expect borrower reliance (whether or not the borrowers have behaved reasonably in so relying), then the final issue presented would be whether the justice would demand contractual enforcement of debt forgiveness and tax treatment terms, in whole or in part. The reasonableness of the borrower’s reliance could, however, be a relevant factor in this final determination as to what resolution of the question most furthers justice.

The principles of promissory estoppel apply to impose contractual obligations upon the federal government in the same manner as they apply to private parties.<sup>131</sup> The law draws a distinction when a party seeks to utilize the earlier and related doctrine of equitable estoppel to bind the government to fraudulent or mistaken representations of its agents. The courts, under such circumstances, will not hold the government liable for those representations unless the agent was acting within the scope of his or her

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<sup>129</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 90 (AM. LAW INST. 1981) (“A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.”).

<sup>130</sup> *Id.*

<sup>131</sup> *Mobil Oil Expl. & Producing Se., Inc. v. United States*, 530 U.S. 604, 607 (2000) (“[W]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.” (quoting *United States v. Winstar Corp.*, 518 U.S. 839, 895 (1996))).

authority.<sup>132</sup> However, when a promissory estoppel claim is based on the authorized promissory representations of a government agent, the rules governing private parties apply.<sup>133</sup>

The promissory estoppel argument is interesting, but there are several plausible counter-arguments against this basis for establishing contractual rights. For one, the express terms of the MPN simply do not promise that the PSLF program's terms will be available indefinitely, nor do they reference any restrictions on tax changes. The MPN instead makes it reasonably clear to a legally sophisticated reader that later legislative enactments may retroactively limit or even eliminate these debt forgiveness and tax privileges.<sup>134</sup> If MPN makes no promises in these respects, this would sharply undercut the promissory estoppel rationale for imposing contractual obligations on the government.

A second, related counter-argument would be that any promises the MPN makes as to the future availability of current PSLF terms or favorable tax treatment, the MPN expressly makes subject to later legislative enactments.<sup>135</sup> It may be reasonable for the government to expect typical student loan borrowers without legal training to overlook the hedged nature of these conditional "promises" and to rely upon them as though they were unconditional commitments. But borrower reliance on a mere hope that program terms and tax laws will remain unchanged, despite the MPN's express references to possible later limiting enactments, is unreasonable. Even if the government should foresee such (unreasonable) reliance to take place, justice arguably does not require the courts to order the government to meet people's unreasonable contractual expectations.

Finally, the promissory estoppel argument raises the subsidiary question of whether to prevail on this argument, a borrower should have to prove actual subjective reliance on continuing availability of PSLF terms and favorable tax treatment, or whether such reliance will be determined by whether an objectively reasonable, hypothetical "average" borrower would have so relied. As with the earlier, similar discussion of implied covenant, if a borrower must prove actual reliance, this would bar most borrowers from a favorable finding.

#### D. *The Unconscionability Argument*

Finally, even if the MPN terms are interpreted to permit the government to subject borrowers to later-enacted legislation that would significantly alter

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<sup>132</sup> *Office of Pers. Mgmt. v. Richmond*, 496 U.S. 414, 419–20 (1990).

<sup>133</sup> *Mobil Oil*, 530 U.S. at 607.

<sup>134</sup> See MPN (2018), *supra* note 55, at 6 ("NOTE: Any amendment to the Act that affects the terms of this MPN will be applied to your loans in accordance with the effective date of the amendment.").

<sup>135</sup> *Id.*

their PSLF program and favorable tax law privileges—even after considering the implied covenant and promissory estoppel theories of contractual obligation discussed above—a final argument can be made that such contractual alterations should not be allowed because they are so unfair and surprising to borrowers as to be unconscionable.<sup>136</sup> This argument would be based on the idea that the MPN provisions that allow for retroactive legislative alterations of loan terms and tax treatment present both procedural and substantive unfairness, satisfying the usual judicial requirement for unconscionability that both forms of unfairness be present to a significant degree.<sup>137</sup> If a court accepted this argument, it could then reform the loan agreements by refusing to enforce the MPN provisions that allow for unilateral statutory amendment. This would effectively give borrowers a contractual right to debt forgiveness and the favorable tax treatment thereof.

The procedural unfairness argument would be that the terse and legalistic MPN provisions relating to the possibility of alteration of the loan terms by subsequent legislation do not clearly reveal to typical borrowers, who lack legal training, the increased burden they could face. This argument would once again present the related sub-issue of whether a fact-specific showing by individual borrowers would be required by courts. Will those borrowers who cannot demonstrate that they were unaware of the possibility of such retroactive legislation at the time they took out their loans be regarded differently and less favorably than those less-sophisticated borrowers who can somehow demonstrate that they were not consciously aware of this risk?

A class action unconscionability challenge to a later-enacted statute that curtails debt forgiveness rights may therefore be required by the courts to subdivide the plaintiff class with regard to the awareness issue. Once again, if courts required that borrowers be able to provide sufficient evidence to demonstrate that they were unaware, at the time of contract formation, of the existence and significance of the MPN terms that make borrower privileges conditional with regard to later statutory amendments, this would be quite burdensome and would likely defeat virtually all borrower claims. However, once again, judicial economy might cause courts to instead apply their determination of the extent of knowledge and understanding of a hypothetical “average” Direct Loan borrower for all such unconscionability claims.

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<sup>136</sup> U.C.C. § 2-302 cmt. 1 (AM. LAW INST. & UNIF. LAW COMM’N 2002) (“The principle is one of the prevention of . . . unfair surprise.”).

<sup>137</sup> See *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449–50 (D.C. Cir. 1965) (“[W]hen a party of little bargaining power . . . signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent . . . was ever given to all the terms. In such a case . . . the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.”).

The substantive unfairness portion of the unconscionability argument would focus on the major financial implications of the loss of those debt forgiveness and tax treatment privileges for borrowers, as compared to the size of the loan obligations they originally undertook. This argument might also present a related sub-issue: Should high-debt borrowers (such as many law school and medical school graduates), who would suffer greatly from the loss of debt forgiveness, be treated differently than those with more modest loan balances, who would not be as strongly impacted? The difference in the significance of losing these privileges may call for another partition of an unconscionability class action into two (or more) groups of different lawsuits on this particular issue.

#### IV. FEDERAL GOVERNMENT POWER TO RETROACTIVELY LIMIT PSLF PROGRAM DEBT FORGIVENESS AND REMOVE THE TAX EXEMPTION FOR FORGIVEN DEBT

If a court were to determine that current Direct Loan borrowers do *not* have *vested* contractual rights to later avail themselves of the PSLF program debt forgiveness privilege or the current tax law treatment of forgiven debts, there do not appear to be any constitutional limitations sufficient to bar enforcement of a federal statute that would retroactively terminate that privilege. But if the program's debt forgiveness terms were left in place and the current tax exemption were eliminated, it is a closer call whether such legislation would pass constitutional due process scrutiny, although I believe that it probably would.

The courts have long permitted tax legislation with retroactive impact for some taxpayers.<sup>138</sup> Since as early as 1880, taxation for a public purpose is not a taking of private property in violation of the Takings Clause of the Constitution.<sup>139</sup> In addition, a taxpayer's mere reliance upon an existing tax provision remaining in force is insufficient to establish that a tax law change is a constitutional violation.<sup>140</sup> However, on occasion, a tax law change with retroactive impact has been challenged as a substantive due process violation on the basis that the length of the period of retroactivity reaching back from the date of statutory enactment is excessive.<sup>141</sup>

Most tax legislation is made retroactive only to the beginning of the year of enactment, and such legislation has been routinely upheld against

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<sup>138</sup> See, e.g., *United States v. Carlton*, 512 U.S. 26, 30–32 (1994) (finding that the 1987 amendment's retroactive application did not violate due process).

<sup>139</sup> *County of Mobile v. Kimball*, 102 U.S. 691, 703 (1880).

<sup>140</sup> *Carlton*, 512 U.S. at 33 ("Tax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code.").

<sup>141</sup> See, e.g., *Welch v. Henry*, 305 U.S. 134, 146 (1938) (describing the appellant's argument that a 1935 tax law denied him due process by imposing a tax on income received in 1933).



substantive due process challenges.<sup>142</sup> However, tax laws that reach back further than one year are, on rare occasions, successfully challenged on substantive due process grounds. For example, in *Nichols v. Coolidge*, the Supreme Court disallowed the retroactive application of an estate tax provision that changed the tax treatment of a property transfer that had taken place twelve years earlier.<sup>143</sup> In a later case, the Supreme Court endorsed this ruling and contrasted it with the different result reached in many other instances where the “retroactive effect is limited.”<sup>144</sup>

A change in the tax laws governing debt forgiven under the PSLF program would potentially have retroactive effects for some borrowers going as far back as 1994 when the Direct Loan program first went into effect,<sup>145</sup> thus far exceeding the twelve years of retroactive application found to be unacceptable in *Nichols v. Coolidge*. This potentially long period of retroactivity exists because while a borrower must have worked for ten years in qualifying public service after October 1, 2007 to obtain debt forgiveness, if the borrower meets that requirement he will be able to have any remaining balance on any Direct Loans forgiven, even if some or all of those loans were taken out prior to October 1, 2007.<sup>146</sup> As a practical matter, the large majority of Direct Loans that will be forgiven under the PSLF program starting in October of 2017 will be post-2007 loans that the borrower will have taken out within ten years or less of the time of seeking debt forgiveness. However, there will likely also be some borrowers who seek forgiveness for Direct Loans taken out more than ten years earlier that were only partially repaid under extended twenty or twenty-five year income-based loan repayment plans. Thus, a tax law change here could conceivably have retroactive impact for a taxpayer extending back as far as 1994!

However, it was not until the PSLF program was adopted in 2007 that a Direct Loan borrower could have formed an expectation of PSLF program debt forgiveness and the tax exemption of this forgiven debt, so perhaps it would be more appropriate to regard the period of retroactive impact of a tax law change as extending back only to October 1, 2007 when those expectations of debt forgiveness and favorable tax treatment could have first arisen, even if some of the loan debts that would later be forgiven were incurred well prior to that date. Still, even if framed this way, such a statute would impose a retroactive period of up to at least ten years—longer for some borrowers if the hypothetical new tax law is adopted after 2017—and

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<sup>142</sup> See, e.g., *United States v. Darusmont*, 449 U.S. 292, 299–300 (1981) (per curiam) (“Congress possessed ample authority to make this kind of change effective as of the beginning of the year of enactment.”).

<sup>143</sup> *Nichols v. Coolidge*, 274 U.S. 531, 542–43 (1927).

<sup>144</sup> *Carlton*, 512 U.S. at 34.

<sup>145</sup> See *supra* note 4 and accompanying text.

<sup>146</sup> See *supra* text accompanying notes 9–15.

therefore would perhaps be open to challenge on substantive due process grounds under the rationale of *Nichols v. Coolidge*.<sup>147</sup> But I doubt that such an argument would prove successful given the broad judicial support for retroactive tax laws<sup>148</sup> and the large revenue consequences of invalidating such a statute, which I have previously estimated would recapture one-quarter to one-third of the \$12 billion to \$18 billion per year of forgiven debt.

For the remainder of this Part, I will assume for the sake of argument that under one or more of the legal theories discussed above, at least some Direct Loan borrowers *do* have contractual rights, both to utilize the current PSLF program terms and favorable tax treatment of debt forgiven. Does the contractual status of those borrowers' rights affect the federal government's ability to retroactively terminate one or both of those rights under the Constitution without providing compensation to the adversely affected borrowers? My conclusion here is that these contractual rights would each be regarded as "private property" and protected against retroactive statutory elimination by the Takings Clause of the Constitution.<sup>149</sup>

The Constitution's Contracts Clause prohibits any state government from adopting a law that would impair its contractual obligations,<sup>150</sup> but it has long been recognized that this provision applies only to the states and not to the federal government.<sup>151</sup> Any constitutional challenge to federal statutes that impair the contractual rights of a private party in a contract with the federal government, such as the contractual rights assumed here, would have to be based on a violation of the Takings Clause of the Constitution, which prohibits the taking of private property without providing just compensation.<sup>152</sup>

Contract rights are generally deemed "private property" as that phrase is used in the Takings Clause,<sup>153</sup> but there are important exceptions to this general rule. For example, in *Bowen v. POSSE*, the Supreme Court stated in sweeping terms that contractual arrangements, including those to which a sovereign itself is a party, remain subject to subsequent legislation.<sup>154</sup> The

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<sup>147</sup> See *supra* note 143.

<sup>148</sup> See, e.g., *Carlton*, 512 U.S. at 30–31 (stating that the Supreme Court "repeatedly has upheld retroactive tax legislation against a due process challenge").

<sup>149</sup> U.S. CONST. amend. V ("[N]or shall private property be taken . . . without just compensation.").

<sup>150</sup> U.S. CONST. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . .").

<sup>151</sup> Elmer W. Roller, *The Impairment of Contract Obligations and Vested Rights*, 6 MARQ. L. REV. 129, 129 (1922).

<sup>152</sup> U.S. CONST. amend. V.

<sup>153</sup> *Id.* See also *U.S. Tr. Co. v. New Jersey*, 431 U.S. 1, 19 n.16 (1977) ("Contract rights are a form of property and as such may be taken . . . provided that just compensation is paid."); *Lynch v. United States*, 292 U.S. 571, 579 (1934) ("Valid contracts are property, whether the obligor be a private individual, a municipality, a state, or the United States.").

<sup>154</sup> *Bowen v. Pub. Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41, 52 (1986).

Court held that the contractual right of the State of California to terminate its participation in the Social Security system did not constitute a property right within the meaning of the Fifth Amendment,<sup>155</sup> but that such a right remained “subject to the sovereign’s jurisdiction, and [that sovereign power] will remain intact unless surrendered in unmistakable terms.”<sup>156</sup> The *Bowen* court distinguished this lesser right from the hardier property rights that would be created by a contractual debt of the government or by a government obligation to otherwise provide benefits under a contract.<sup>157</sup>

Under *Bowen*, if the Direct Loan borrowers have a contractual right to invoke PSLF debt forgiveness as I am assuming here, this right would appear to be a governmental obligation to provide benefits, and the government’s right to unilaterally alter or terminate those benefits has been “surrendered in unmistakable terms.”<sup>158</sup> That right would, therefore, deserve the usual “private property” protections of the Takings Clause and would bar its termination by statute without the government providing compensation. Similarly, if these Direct Loan borrowers also have a contractual right to the currently favorable tax exemption for forgiven debt, under *Bowen* this right would also appear to be a government obligation to provide benefits, meriting the same Takings Clause protection. The retroactive taxation jurisprudence briefly discussed above that broadly allows the adoption of tax laws with retroactive impact (if the period of retroactivity is not excessively long) does not appear to be applicable here because those prior cases allowing for retroactive measures do not address the unusual circumstances assumed to be present where the government has specifically contracted to provide a certain tax treatment for a transaction.

### CONCLUSION

As I have discussed above, I believe that the express language of the MPN should be interpreted to allow the government to retroactively impose statutory limitations upon, or even eliminate, PSLF program debt forgiveness privileges for prior Direct Loan borrowers<sup>159</sup> and to change the tax laws applicable to any later forgiven debt. Direct Loan borrowers do *not* appear to have an express contractual right to either debt forgiveness or favorable tax treatment of forgiven debt.

Under the implied covenant of good faith and fair dealing, however, some borrowers can make a fairly strong case that they have an implied contractual right to debt forgiveness and current favorable tax treatment of debt so forgiven. If not all borrowers have this right, then it should be

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<sup>155</sup> *Id.* at 55.

<sup>156</sup> *Id.* at 52 (quoting *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 148 (1982)).

<sup>157</sup> *Id.* at 55 (citing *Lynch*, 292 U.S. at 576–77).

<sup>158</sup> *Id.* at 52 (quoting *Merrion*, 455 U.S. at 148).

<sup>159</sup> The DOE and the AccessLex Institute are of the same opinion here. See *supra* notes 114–15 and accompanying text.

recognized at least for those few borrowers who can demonstrate that they reasonably expected to have such contractual rights when they entered into their loan agreements.

In addition, a related but distinct argument can be made that the government should be bound by promissory estoppel principles of contractual commitments to honor those debt forgiveness and tax treatment privileges originally articulated in the Direct Loan documentation—again, if not for all borrowers, then at least for those who can demonstrate that they actually relied upon later having those rights when they entered into their loan agreements or took public service employment. However, as I have noted, there are several strong counter-arguments that can be made against imposing contractual liability on the government here on a promissory estoppel theory.

Finally, a fairly robust unconscionability challenge can be mounted against enforcement of MPN terms that allow for retroactive elimination of PSLF debt forgiveness by later-enacted statutes, seeking reformation of those contracts to protect borrowers against such statutes—if not for all borrowers, then at least for high-debt borrowers who can demonstrate that they were both unaware of this possibility at the time of contracting and who would be severely impacted by the loss or substantial curtailment of their debt forgiveness rights.

In summary, I think that it is an open question whether the courts would regard the PSLF program terms as a contractual obligation of the government under the post-October 1, 2007 Direct Loan agreements (rather than as merely a revocable privilege) under one or more of the above contractual theories of liability if this matter were litigated in the context of retroactive statutory curtailment or elimination of those privileges. I have considered several arguments that could be made in this regard, and while some of them have considerable merit, at least for a small subset of Direct Loan borrowers, the proper resolution of the question as a matter of positive law is unclear. For the reasons that I have discussed, however, I think that it is much less likely that the courts would regard the privilege of favorable tax treatment of debt forgiven under the PSLF program as a contractual obligation of the government.

If one assumes for the sake of argument that the existence of borrower contractual rights to both debt forgiveness and favorable tax treatment can be justified by one or more of the above theories, that raises the difficult question as to whether the federal government then still has the power under the Constitution to retroactively abrogate one or both of those contractual rights by statute. I have concluded that a strong case can be made that if borrowers have contractual rights both to debt forgiveness and to the current favorable tax treatment of forgiven debt, these rights should be regarded as property rights that cannot be retroactively abrogated without the payment of compensation under the Takings Clause.

The Obama Administration's 2014 proposal to limit PSLF program eligibility was not adopted,<sup>160</sup> nor was the 2017 Trump Administration proposal to prospectively abolish the PSLF program altogether for most Direct Loans taken out as of July 1, 2018.<sup>161</sup> But given the large annual cost this program is likely to impose upon the Treasury once substantial numbers of people begin to obtain debt forgiveness, and given the regressive distribution of the benefits of the program's benefits in favor of mid-career lawyers and doctors, there are likely to be attempts to statutorily curtail or eliminate this program—or to reduce or eliminate its favorable tax benefits—in a manner that will have retroactive impacts upon prior Direct Loan borrowers.

Finally, if such statutes with retroactive impacts are adopted, there will surely be court challenges to those statutes asserted along the lines of the arguments that I have outlined above. Such challenges will present not only difficult legal issues but also hard policy questions as to how to best balance the widespread reliance of existing borrowers to have their debt forgiven against legitimate public concerns regarding the program's costs and regressive benefits.

I do not have strong feelings or any special insights as to how this tension should be resolved. I do suggest for discussion one possible compromise approach: Congress could adopt a statute which continues unchanged the PSLF program's debt forgiveness eligibility and benefits but treats debts forgiven under the program as taxable income, as is now done for the other federal income-based loan repayment programs. Such a statute would immediately recapture approximately one-quarter to one-third of the debt forgiveness benefits in new income tax revenues and would do so in a modestly progressive manner as it imposed larger taxes on higher-debt (and presumably also higher-earning) lawyers and doctors. This approach would, however, create a troubling impact in that many persons would be burdened with potentially substantial income tax obligations without the funds to pay those taxes.<sup>162</sup> For the typical undergraduate borrower with a \$30,000 initial loan debt and approximately \$25,000 of debt forgiven,<sup>163</sup> this would impose a tax liability of approximately \$5,000 to \$6,000—a significant but not crushing financial obligation. For lawyers or doctors with upwards of \$200,000 of debt forgiven,<sup>164</sup> however, tax bills could easily be as high as

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<sup>160</sup> See *supra* note 2 and accompanying text.

<sup>161</sup> See *supra* note 3 and accompanying text.

<sup>162</sup> See Crespi (2016), *supra* note 25, for an extensive discussion of the comparable tax bomb that will be imposed by the PAYE and Income-Based Repayment plans on high-debt law school graduates when millions of Direct Loan borrowers will have their remaining debts forgiven under one or another of those plans after either twenty or twenty-five years of making repayments.

<sup>163</sup> See *supra* note 44 and accompanying text (discussing calculation of student loan debt).

<sup>164</sup> See *supra* note 48 and accompanying text (discussing average student loan debt for law school students).

\$50,000 to \$70,000 or more, which may well be beyond some persons' capacity to pay.

In an earlier article, I analyzed the comparable impacts for high-debt law school graduates of large forgiven debts of \$200,000 or more being treated as taxable income under the PAYE and Income-Based Repayment plans after either twenty or twenty-five years, as they now are. There, I suggested that the Code should perhaps be revised to give these persons several years to pay these taxes, with only a modest interest rate imposed for the privilege of making deferred payments, rather than requiring that the taxes all be paid in the year of discharge.<sup>165</sup> The argument for a comparable deferred payment provision to be included in any repeal of the PSLF program tax exemption is even stronger, given that these persons will generally have had only about ten years to set aside funds in anticipation of these taxes, and moreover they will have had to do so out of relatively modest public service salaries. This in contrast to having twenty or twenty-five years to build up a dedicated fund out of often larger public or private sector incomes to pay these taxes, as borrowers have for the other income-based repayment plans. Another possible mitigating statutory option here would be to allow those persons who have debts forgiven under the PSLF program to elect to pay those taxes over time in accordance with the terms of their prior loan repayment program, thereby giving them another ten to fifteen years to repay their tax debt at the original student loan interest rate. This approach would be equivalent to forgiving two-thirds to three-quarters of their loan debt without imposing any tax obligation and then requiring repayment of the balance of the debt on the same terms as before. There would thus be no large tax imposed in the year in which the remaining debts are (partially) forgiven. The borrower would continue to make smaller loan repayments for another ten to fifteen years until any remaining debt is forgiven, and then that forgiven debt would be treated as taxable income in the year of final forgiveness as the tax laws now require.

There are of course numerous other possible compromises to balance the competing legitimate interests of borrowers with the interests of the general taxpaying public. Whatever the resolution, the sooner these questions are resolved, the better for all concerned given the virtual flood of applications for debt forgiveness under the PSLF program that is almost upon us.

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<sup>165</sup> Crespi (2016), *supra* note 25, at 196–97.